# Latvia

BUSINESS FORUM
LONDON 22-24 APRIL 2001

# Investment Profile 2001



**Held on the occasion of the EBRD ANNUAL MEETING**


# Contents



This document was drafted by the EBRD Country Promotion Programme team assisted by Bank staff and the Latvian authorities. It was prepared with information available up to March 2001, derived principally from the EBRD, the EU, the IMF, the Latvian Privatisation Agency, the Central Statistical Bureau, the Bank of Latvia, the EIU, Oxford Analytica, and Hilfe. Every effort has been made to ensure accuracy. However, no responsibility is accepted for the contents of this document.
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# Foreword

This year the EBRD is celebrating the tenth anniversary of its operations. During these years, through its participation in a number of projects in the public as well as the private sector, the EBRD has played a significant role in the transition process in Latvia.

I believe it is also thanks to the Bank's contribution that Latvia is today among the EU accession countries. In late 1999 the country received an invitation from the European Union to start accession negotiations, which marks a new phase in its transition. Accession negotiations were opened in February 2000 on eight chapters of the EU's *acquis communautaire*. Another eight chapters were opened for negotiations during the second half of 2000: freedom to provide services, free movement of capital, company law, fisheries, transport, EMU, industrial policy and consumer and health protection. In line with this we are glad to see that the EBRD explicitly demonstrates its willingness to contribute to the development and further growth of the countries in the region through its involvement in EU integration.

It is an immense pleasure for me to introduce this publication to the reader, as it is a handy source providing the investor with concise information on the country. The Annual Meeting of the EBRD Board of Governors held in Riga in spring 2000 was an excellent opportunity for Latvia to demonstrate its dynamic development and to create awareness among international investors of the investment possibilities in the country. I believe the delegates and guests attending the Meeting have had the opportunity to experience the environment for themselves, and to form their own associations with the name "Latvia".

**Roberts Zile**
Minister for Special Assignment for Cooperation
with International Financial Agencies
Republic of Latvia


# Introduction

***Latvia is one of the advanced transition countries. With its prime location as a transit hub for east-west trade, the country has a well-developed service sector, and the economy has a strong industrial backbone inherited from the industrialisation process started in the 1950s to supply the Soviet market. Since its independence in 1991, the country has made rapid advances in its transition towards a market economy and has attracted considerable foreign investment. In the EU accession negotiations that started in March 2000, Latvia appears to be the only country in the "second tier" that stands a chance of catching up with the first-wave countries.***

Latvia has made considerable progress in price and trade liberalisation, small and large-scale privatisation and financial sector reform. As a result, the economy has grown by an average of 3 per cent yearly since 1994. Following virtual stagnation in 1999 in the aftermath of the Russian financial crisis, real GDP growth is likely to have amounted to 5-6 per cent in 2000 and to continue at this pace in 2001.

One of the main reform challenges for Latvia in 2000 was to maintain macroeconomic stability, given the country's current account deficit. Fortunately, there has been a recent improvement in the current account deficit, which decreased substantially in 2000 compared to 1999.

### *The challenges ahead*

The government should accelerate restructuring and privatisation of the remaining large-scale infrastructure companies in order to enhance the investment climate and attract FDI.

The most important challenge is to reach a political consensus on a consistent set of objectives to complete the privatisation of large-scale enterprises and to develop an appropriate regulatory framework to foster competition in the infrastructure sectors. The new government has agreed that international advisors, selected through public tenders, are to be involved in advising the government authorities on concluding the privatisation of three of the remaining large-scale majority state-owned enterprises (the Ventspils Nafta oil terminal, telecom monopoly Lattelekom and shipping company LASCO). There now appears to be increased consensus on privatisation in the transport and telecom sectors and possibly on restructuring in the energy sector.

The government is currently drafting a new energy sector policy and has passed a new telecommunications law, which will serve to enhance the independence of utility regulators and ensure that pricing is based on economic criteria. At the same time, the Saeima (parliament) passed a law in October 2000 stipulating the creation by September 2001 of a single regulatory agency with responsibility for public utilities by September 2001. In the reform of the regulatory regime, it will be crucial that the regulator has the necessary expertise and is granted operational independence and sufficient resources.

Another challenge is that the development of the capital markets and the sustainability of public finances should be accelerated through the implementation and further reform of private pensions legislation. Following the enactment of a law on private voluntary pension funds in July 1998, Latvia is gradually moving away from the old pay-as-you-go pension system. Four private pension funds now hold licences, and while they are at an early stage of development, they all appear to be developing well. In early 2000 the Saeima adopted the Law on State-Funded Pensions for the second pillar of the pension system, for which contributions will be collected from July 2001. In order to help ensure that the three-pillar system is financially sustainable, the government has committed to submit additional amendments to the law.

Latvia's party political landscape is fragmented and appears to be in a state of flux. It is divided along the lines of key personalities and business interests rather than consistent party programmes. While the larger parties are consolidating, new ones are springing up and a number of deputies in the Saeima have changed parties. Following the general elections of October 1998, there were two short-lived governments before the current prime minister, Andris Berzins, took office in April 2000. His consensus-oriented approach appears able to bridge policy differences within the centre-right coalition. However, one of the coalition partners, the New Party, departed from the government in early February 2001. Municipal elections were held in March. The President since 1999, Vaira Vike-Freiberga, has built up a strong conciliatory position in Latvian politics. She is consistently rated as the country's most popular politician, and in a positive and constructive manner has raised Latvia's profile in international organisations, most notably the EU.

### *International relations*

NATO and EU accession remain Latvia's two foreign policy priorities. In 1994 the country joined the NATO Partnership for Peace, and the US-Baltic Charter was signed in 1998, but Latvia has not yet been offered full NATO membership. In 2002 a NATO summit will determine whether to invite any new members into the alliance. Although the door has, in principle, been left open to Baltic membership, Russia's opposition to NATO expansion has been a major obstacle. Latvia's relations with Russia since independence have been shaped by mutual business interests. The attitude towards the social integration of the large Russian minority in Latvia has further improved since October 1998, when Latvians voted in favour of amendments to the citizenship law, opening the way for naturalisation of all Russian residents. In December 1999 Latvia adopted a new state language law. These steps have earned Latvia the approval of the Organisation for Security and Co-operation in Europe (OSCE) and the EU. A recent meeting between the presidents of Latvia and Russia and a forthcoming meeting of the bilateral economic working group are expected to give new impetus to Latvian-Russian economic and political relations.

Political relations with Estonia and Lithuania have traditionally been close, and economic co-operation between the Baltic republics has become a vital feature of their recent transition. The three countries are increasingly trading and investing in each other's economies. In addition, the role of the Nordic countries is of vital interest for the economic development of the Baltic republics. Finland, Norway, Sweden and Denmark are major investors in Latvian enterprises. Latvia is also participating in regional co-operation in various fields, in which the Baltic Sea countries, including Poland and Russia, are involved.

### *EU accession prospects*

Latvia's objective of EU membership is at the heart of its foreign policy. A free trade agreement with the EU was signed in 1994, followed by the more comprehensive Europe Agreement in 1995. The latter came into force in early 1998 and forms the basis of Latvia's pre-accession partnership.

Unlike neighbouring Estonia, Latvia was not among the central and east European countries invited to join the first wave of accession negotiations in 1997. However, Latvia now appears to stand a chance of drawing alongside the first-wave countries.

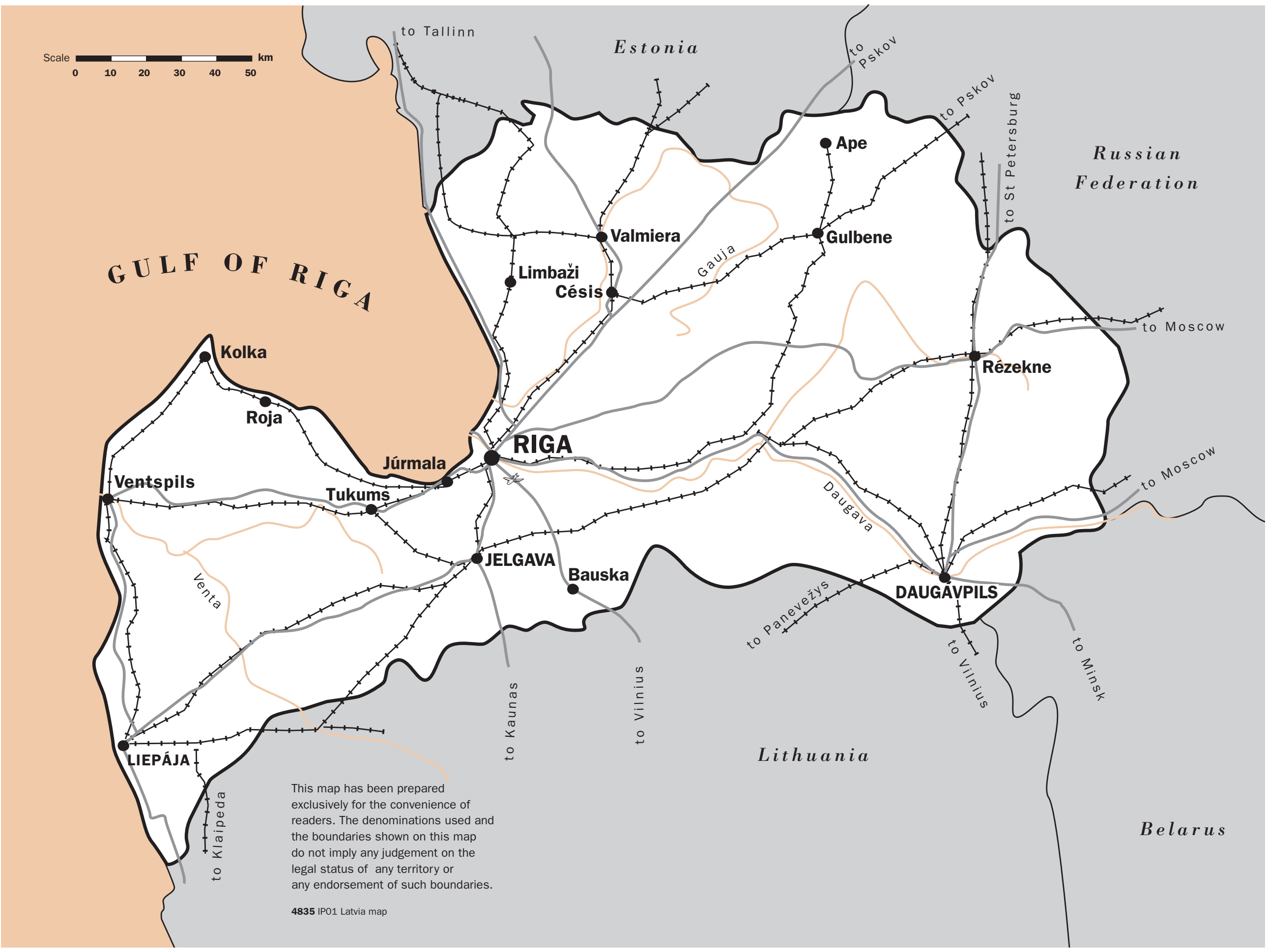
Latvia received the long-awaited invitation to start accession negotiations in late 1999 following a shift in the EU enlargement strategy and after the European Commission had acknowledged good progress in EU accession preparations in its annual reviews in 1998 and 1999. Accession negotiations were opened in February 2000 on eight chapters of the EU's *acquis communautaire*, relating to SMEs, research, education, external relations, the EU's foreign and security policy, competition policy, statistics, culture, and audio-visual policy. Another eight chapters were opened for negotiations during the second half of 2000: freedom to provide services, free movement of capital, company law, fisheries, transport, EMU, industrial policy, and consumer and health protection.

Latvia has concluded negotiations on nine chapters of the *acquis*, but difficult chapters such as those on agriculture and the free movement of labour have yet to be addressed. The government is planning to complete negotiations on all 31 chapters by the end of 2002.

In the latest Regular Report of November 2000, the Commission commended Latvia for its EU accession preparation and for its economic achievements for the third year running. It noted that Latvia can be regarded as a functioning market economy and should be able to cope with competitive pressure and market forces in the EU in the medium term, provided that it completes and maintains the pace of its structural reforms.

The report stresses that efforts to adopt the *acquis* have been satisfactory, especially given Latvia's frequent changes of governments. The Commission stressed the necessity of ensuring efficient implementation and enforcement of EU rules. It observed positive developments in strengthening the public administration but indicated that institutional capacity still needs to be increased. The current prime minister has vowed to tackle administrative reform and some progress has been made in improving the overall investment climate. The government is intensifying its fight against corruption.

With robust economic growth forecast and the country firmly on track for EU accession, the year 2001, in which Riga celebrates its 800th anniversary as a city, looks promising.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GULF OF RIGA
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Ventspils
Tukums
Daugava
to Moscow
JELGAVA
Bauska
Venta
to Panevežys
DAUGAVPILS
to Vilnius
to Minsk
to Kaunas
to Vilnius
LIEPÁJA
Lithuania
to Klaipeda
Belarus
This map has been prepared exclusively for the convenience of readers. The denominations used and the boundaries shown on this map do not imply any judgement on the legal status of any territory or any endorsement of such boundaries.
4835 IP01 Latvia map

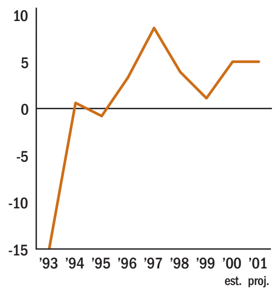

# Economic summary

***Latvia recorded impressive GDP growth in 2000, which is likely to be sustained in 2001. Inflation was at a record low level and there was an improvement in the current account deficit due to substantial export growth, increased industrial production and improved domestic demand. The EU country progress report states that Latvia has a functioning market economy but urges for further progress in structural reforms. Like the EU, both the IMF and the World Bank warn against delays in privatisation and restructuring. The government is also deviating significantly from the fiscal deficit targets agreed with the IMF at the end of 1999.***

## GDP growth

Following virtual stagnation in 1999 in the aftermath of the Russian financial crisis, real GDP growth in the first three quarters of 2000 reached 5.4 per cent, and economic developments in the last quarter suggest that Latvia's GDP in 2000 as a whole rose well in excess of 5 per cent, compared to 1.1 per cent in 1999. While Ministry of Finance statistics give a conservative estimate of 5 per cent, the Ministry of Economy estimates GDP growth in 2000 at 5.7 per cent. Export volumes have expanded steadily since the third quarter of 1999, industrial production growth was positive every month in 2000 with the exception of April, and there has been a brisk recovery in domestic demand. The economy has grown by an average of 3 per cent since 1994. Growth is forecast to maintain the current high level in 2001.

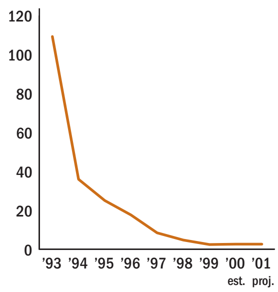
**GDP**
*% change*




## Inflation

Inflation was at its lowest level ever in 2000, equalling the levels in most of the EU countries. End-year inflation stood at 1.8 per cent while the annual average was 2.6 per cent, according to government statistics. Inflation is not projected to increase sharply in 2001 due to rather subdued changes in administrative prices. These prices account for 21 per cent of the total basket of goods and services. The same figure of 2.6 per cent annual average inflation is forecast by the Ministry of Finance for 2001.

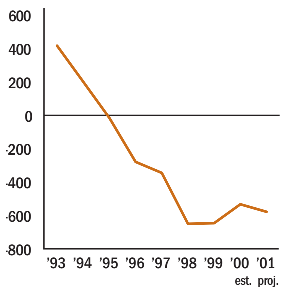
**Consumer prices**
*Annual average, % change*




## Current account and trade balance

There has been a recent improvement in the current account deficit. According to Bank of Latvia statistics, while in the third quarter of 1999 the current account deficit amounted to 8.9 per cent of GDP, in the corresponding quarter of 2001 the deficit had narrowed to 5.8 per cent. The improvement in the current account is likely to have been brought about by increasing exports of services, justifying the peg of the lat to the SDR basket. Exports in the third quarter increased by 11.1 per cent, while imports grew by 9.9 per cent despite high oil prices inflating the import bill. In 2001, a current account deficit of 7.0 per cent is projected.

**Current account**
*US$ millions*

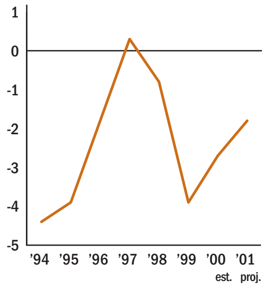



*Source: Ministry of Finance, February 2001*

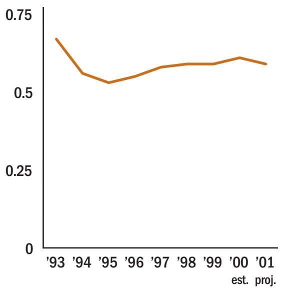
## Government balance

Following a deficit of 3.9 per cent of GDP in 1999, the Stand-by Agreement with the IMF aimed to reduce the fiscal deficit to 2 per cent in 2000. The 2000 budget deficit was revised upwards at the beginning of November 2000 to 3.2 per cent of GDP. Using the IMF definition whereby privatisation receipts are included as financing and not as revenue this would imply a deficit of around 3.6 per cent. Preliminary data indicate that the 2000 fiscal deficit reached 2.75 per cent

**General government balance**
*% of GDP*




**Exchange rate**
*Annual average, lats per US$*




*Source: Ministry of Finance, February 2001*

of GDP or higher, according to the IMF definition. Latvia has also revised the 2001 deficit target from 1 per cent of GDP agreed with the IMF to 1.74 per cent of GDP. This partly reflects the fact that the government is facing substantial expenditure in several areas, a large amount of which is associated with the costs of preparing for EU and NATO accession.

## Exchange rate

Latvia has maintained the lat (LVL) peg to the SDR (around US$ 0.61 in 2000), despite pressures on reserves during 1998 and 1999, and has kept full foreign exchange coverage of base money intact. A significant reorientation of trade towards the EU since 1999 has offset real currency appreciation on a trade-weighted basis. Given an expected depreciation of the dollar in 2001 some appreciation of the lat to a level of US$ 0.59 annual average is expected.

## EU accession

Latvia received favourable comments in the latest EU country progress report for its economic achievements for the third year running, according to which Latvia has a functioning market economy and might be able to join the EU in the first enlargement. The Commission warns, however, that further progress is needed in many areas of structural reform if economic recovery is to continue, and stresses the necessity to ensure efficient implementation and enforcement of EU rules (see *Introduction* above).

## IMF agreements

A new stand-by arrangement with the IMF was agreed in December 1999 for the amount of US$ 45 million. The programme called for strict fiscal tightening with an agreed target deficit of 2 per cent of GDP in 2000 and 1 per cent in 2001, and a comprehensive schedule for large-scale privatisation (although most of which had slipped by January 2001). However, the government has deviated from the agreed targets, since the Ministry of Finance in November 2000 revised last year's deficit upwards to 3.2 per cent and the 2001 deficit to 1.74 per cent of GDP.

## World Bank

In March 2000, the World Bank and the Latvian government agreed on a Programmatic Structural Adjustment Programme for Latvia. Latvia received the first tranche of US$ 40 million after the Structural Adjustment Loan (SAL) was agreed in March 2000. The agreement was reached between the government and the World Bank on the condition of a further timetable of privatisation and institutional reform. Delays in the timetable for the agreement could threaten the second tranche of the three-year SAL.

## *Credit ratings*

### Standard & Poor's

| Local currency | | | Foreign currency | | |
|---|---|---|---|---|---|
| Long-term | Outlook | Short-term rating | Long-term rating | Outlook | Short-term |
| A- | Stable | A-2 | BBB | Stable | A-3 |

### Moody's

| Bonds and notes | | Bank deposits | |
|---|---|---|---|
| Long-term | Short-term | Long-term | Short-term |
| Baa2 | P-3 | Baa3 | P-3 |

### Fitch IBCA

| Long-term | Short-term |
|---|---|
| F3 | BBB |

### Selected economic indicators

| | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 est. | 2001 proj. |
|---|---|---|---|---|---|---|---|---|---|
| GDP (% change) | -14.9 | 0.6 | -0.8 | 3.3 | 8.6 | 3.9 | 1.1 | 5.0 | 5.0 |
| Consumer prices (annual average % change) | 109.2 | 35.9 | 25.0 | 17.6 | 8.4 | 4.7 | 2.4 | 2.6 | 2.6 |
| Current account (in US$ millions) | 417 | 201 | -16 | -279 | -345 | -650 | -646 | -533 | -578 |
| General government balance (% of GDP) | na | -4.4 | -3.9 | -1.8 | 0.3 | -0.8 | -3.9 | -2.7 | -1.8 |
| Trade balance (in US$ millions) | 3 | -301 | -580 | -798 | -848 | -1,130 | -1,027 | -1,123 | -1,202 |
| Total FDI (in US$ millions, cash receipts, net) | 50 | 279 | 245 | 379 | 515 | 303 | 331 | 345 | 376 |
| External debt stock (US$ millions) | na | na | 1,415 | 2,025 | 2,731 | 3,060 | 3,803 | 4,213 | 4,623 |
| Unemployment (% of labour force) | 8.7 | 16.7 | 18.1 | 19.4 | 14.8 | 14.0 | 13.5 | 13.0 | na |
| Exchange rate, annual average, lats per US$ | 0.67 | 0.56 | 0.53 | 0.55 | 0.58 | 0.59 | 0.59 | 0.61 | 0.59 |
| Gross reserves, excluding gold (year-end, US$ millions) | 432 | 545 | 506 | 622 | 704 | 728 | 840 | 927 | 1,109 |

*Source: Ministry of Finance, February 2001*

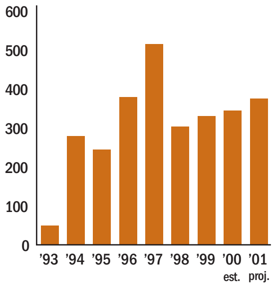

# Investment climate

***Latvia has a liberal market economy and favourable investment climate and continues to attract reasonable foreign investment, especially in transit trade and finance. Since the 1998 crisis, enterprise restructuring has been successful and foreign trade has been reoriented towards EU markets. The privatisation process is almost complete with only some large companies in the energy and transport sectors left to be privatised. These privatisations were delayed in 2000, but could regain momentum in 2001. The privatisation of a stake in the gas utility and the restructuring and privatisation of a large bank have been successful. Further improvements to the legal and judicial framework have been carried out, such as the introduction of a new Commercial Code, amendments to the tax legislation and border crossing procedures, with the aim of harmonising them with those of the EU.***

## Foreign direct investment

After robust net foreign direct investment (FDI) in 1997 (US$ 515 million), the net total declined in 1998 (US$ 303 million) and amounted to US$ 331 million in 1999. In 2000, Latvia received more FDI than in 1999, and the inflows are expected to increase further in 2001. According to Ministry of Finance statistics, net FDI into the Latvian economy amounted to US$ 345 million in 2000, while in 2001 a further increase to US$ 376 million is projected. According to IMF estimates, Latvia received net FDI inflows of around US$ 380 million in 2000, while for the year 2001 about US$ 410 million of FDI is projected, depending on progress with large-scale privatisation and on restructuring in the energy sector.

***Total FDI***
*US$ millions, cash receipts, net*




*Source: Ministry of Finance, February 2001*

Germany, Estonia, Sweden and Denmark were the sources of most FDI into the Latvian economy in 2000. The sectors attracting most FDI in 2000 were real estate, gas supply and manufacturing.

Cumulative net FDI inflows from 1993 until the end of 2000 amounted to approximately US$ 2.45 billion, according to Ministry of Finance statistics. The largest investment by far to date was in the telecommunications sector, when Sonera (Finland) via its subsidiary Tilts Communications (Denmark) invested US$ 305 million in Lattelekom (the telecoms monopoly). The financial sector also received a considerable share of FDI when Skandinaviska Enskilda Banken (SEB, Sweden) invested in Unibanka and Vereinsbank und Westbank (Germany) in Vereinsbank Riga, and MeritaNordbanken (Sweden/Finland) acquired the Latvian Investment Bank. In 2000, Norddeutsche Landesbank (Germany) acquired Pirma Latvijas Komercbanka. Norway's Varner Group has made substantial investments in real estate.

**Top 10 foreign investors**

| Name | Country | Sector | Investment | Investment value, US$m |
|---|---|---|---|---|
| Sonera | Finland | Telecoms | Lattelekom | 305.0 |
| Transnefteprodukt | Russia | Transit of oil products | Latrostrans | 61.8 |
| Varner Gruppen, ICA/Hakon Gruppen, Linstow ASA | Norway | Real estate | Linstow Varner | 75.0 |
| New Century Holding | US | Real estate | New Century Holding | 50.0 |
| Polarbek | US | Hotel | Radisson SAS Daugava | 42.0 |
| Ernesto Preatoni Group | Italy | Real estate | Pro Kapital Latvia | 40.0 |
| Den Norske Stats Oljeselskap | Norway | Trade of oil products | Latvija Statoil | 60.0 |
| Skandinaviska Enskilda Banken | Sweden | Finance | Unibanka | 55.0 |
| Shell | UK/Netherlands | Trade of oil products | Shell Latvija SIA | 30.0 |
| Vereinsbank und Westbank | Germany | Finance | Vereinsbank Riga | 24.0 |

*Source: Latvian Development Agency, Ministry of Finance, February 2001*

**Top 10 sources of investment,** as at 1 October 2000

| Country | Total accumulated FDI stock US$m | % of total | Country | Accumulated FDI in company capital US$m | % of total |
|---|---|---|---|---|---|
| USA | 231.23 | 11.8 | Denmark | 188.98 | 13.9 |
| Germany | 222.77 | 11.4 | Germany | 163.91 | 12.1 |
| Denmark | 217.39 | 11.1 | USA | 153.16 | 11.3 |
| Estonia | 197.36 | 10.1 | Sweden | 106.79 | 7.9 |
| Sweden | 178.71 | 9.1 | Russia | 92.79 | 6.8 |
| Finland | 126.75 | 6.5 | UK | 88.95 | 6.6 |
| Russia | 108.92 | 5.6 | Estonia | 78.49 | 5.8 |
| UK | 97.69 | 5.0 | Finland | 68.37 | 5.0 |
| Norway | 82.13 | 4.2 | Norway | 55.43 | 4.1 |
| Netherlands | 53.10 | 2.7 | Netherlands | 40.17 | 3.0 |

*Source: Bank of Latvia, Central Statistics Bureau, February 2001*

## Investment policy and incentives

Under the Law on Foreign Investment, foreign investors are entitled to national treatment in all aspects of business regulation. Almost all existing restrictions for foreigners were lifted by amendments to the law in 1996, although there are some notable sectoral exceptions, such as forestry, gambling, broadcasting, airlines and insurance. Foreign direct investment into the banking sector also requires the approval of the central bank. In an early 1998 report on Latvia, the OECD considered that the law offered the same standards of protection as similar laws in OECD member states.

There are no restrictions on foreign investors establishing a legal entity and starting business activity in Latvia. Foreign investors have the right to engage in entrepreneurial activity in any permitted legal form (see *Commercial Code* below). Provided that a company does not breach competition protection laws, foreign investments can also freely take the form of take-overs, mergers and acquisitions. The Competition Act has been effective since 1997, providing for a Competition Board, which replaced the previous Anti-Monopoly Committee.

The expropriation of foreign investments is possible, within restrictive limits, under the Law on Expropriation of Real Property. In such exceptional cases, compensation has to be paid by the state within three months, and the owners of the property have the right of appeal. There have been no cases of expropriation by the government since Latvia's independence in 1991. Latvia offers complete current account and capital account convertibility, and this open regime has proven effective. Earlier restrictions on foreign persons owning real estate have also been largely lifted. Foreign investors are now allowed to lease land for up to 99 years.

A new Commercial Code replacing existing business legislation was adopted by the Saeima on 13 April 2000 and is effective from 1 April 2001. The main aim of the Code, which brings Latvian commercial law closer to that of the EU, is to introduce a better and simpler structure for commercial operations. Among other acts, the Commercial Code abolished the Foreign Investment Act of 1991. The provisions granting tax holidays and reliefs to companies that received foreign investment prior to 1 April 1995 have been included in the Commercial Code Implementation Act. However, the tax relief period would not extend beyond 31 December 2010, which could be painful for companies which have made large investments and by then are only just beginning to reap the rewards.

Representative offices will have to be reorganised or liquidated by 31 March 2002. Permanent representative offices (permanent establishments) of foreign companies, which have not been registered as branches or companies by the end of March 2003, will be liquidated. The Commercial Code does provide, however, for foreign entity representative offices which are not legal entities and do not trade in Latvia. (See box for more details of the new Commercial Code.)

The Saeima also enacted the new Business Control Act, which was adopted on 23 March 2000 and generally took effect on 27 April 2000. The act governs the relationship between a controlling entity and a controlled company. Necessitated by the adoption of the Business Control Act, amendments to other business legislation were adopted, designed to ensure consistency of treatment.

The government has introduced refunding of VAT for fuel purchased in Latvia by international transport companies

### The Commercial Code

The new Commercial Code, effective from 1 April 2001, replaces various laws which governed different forms of business (e.g the Joint Stock Companies Act, the Limited Liability Companies Act, etc.). Under the Code, the number of business forms are reduced from 13 to five: sole trader, unlimited partnership, limited partnership, limited liability company, and joint stock company. Re-registration is necessary at the Commercial Registry, the former Companies Registry. Registration will now take a maximum of three days instead of the previous 15.

The Code provides a legal framework for brokers and commercial agents. Partners in a partnership can now be limited companies and no longer only individuals. The practice whereby the general meeting releases board and council members from liability each year upon approval of the annual account was discontinued. The Code includes a set of provisions governing the authorisation of representatives, requiring certain authorisations to be registered with the Commercial Registry.

For limited liability companies, the Code lifts restrictions on the number of shareholders, enables transferring ownership of shares only upon approval of the general meeting, and permits a single-member board. For joint stock companies the capital requirement was increased from LVL 5,000 (US$ 8,090) to LVL 25,000 (US$ 40,460), to be adjusted within five years. Shareholders no longer elect both board and council, but the general meeting elects the council, which elects the board. The list of resolutions that can only be adopted by the general meeting has been shortened. The Code abolishes the requirement for a quorum at a general meeting. As long as 75 per cent support is achieved at a general meeting, pre-emptive rights of shareholders can be ignored where capital is increased through debt conversion.

and reduction in excise taxes for diesel from 1 January 2001 to stimulate the road transport industry. Corporate tax breaks for large investments also came into force on 1 January 2001. (See *Taxation and social expenditure* below.)

Based on the April 1999 World Bank FIAS Report on Administrative Barriers to Investment in Latvia, the subsequent Action Plan approved in May 1999, and the recommendations of the Foreign Investors' Council in Latvia which resulted in a pooled Action Plan approved in February 2000, a number of initiatives are now under way to improve the business environment. Among other things these initiatives are aiming to cut red tape, decrease possibilities for corruption and reduce the costs of creating new businesses.

### Special Economic Zones

Presently, two Special Economic Zones (SEZ) and two Freeports are mandated by law in Latvia: Ventspils Freeport, Riga Freeport, Liepaja SEZ (including Liepaja port), and Rezekne SEZ. The SEZs not only enjoy free zone status, but also considerable tax incentives. There are various depreciation rates for different types of fixed assets and for enterprises in the SEZs. Latvia adopted a Law on State Aid in 1998 under which the assessment of the compatibility of aid can be carried out by way of direct application of the Europe Agreement and thus the Community acquis. Priority must now be given to bringing existing aid measures in line, most notably as regards Special Economic Zones (by eliminating the export aid elements) and Free Ports.

### Latvian Development Agency

The Latvian Development Agency (LDA) was established in 1993. The Council of the LDA is headed by the minister of economy and consists of nine members including the ministers of foreign affairs, finance, regional development and environmental protection, as well as representatives of the private sector. The LDA provides information on doing business in Latvia, contacts with Latvian business partners, business visit programmes in Latvia, identification of the best property options, assistance with start-up procedures, and follow-up services for investors. In addition, the LDA offers export-related services, including information on Latvian exporting companies and export products, information on the export potential of Latvian industry sectors, placement of export and subcontract orders in Latvian companies, and arrangement of trade seminars and foreign trade missions into Latvia. The LDA has representative offices in London and Frankfurt. For further information:

Latvian Development Agency
Perses 2, Riga LV 1442, Latvia
Tel: +371-7 283425, +371-7 287534
Fax: +371-7 820458, +371-7 282524
E-mail: ***invest@lda.gov.lv***
Web site: ***www.lda.gov.lv***

## Privatisation and restructuring

Privatisation is governed by the Law on Privatisation of State and Municipal Property, and the privatisation programme is carried out by the Latvian Privatisation Agency (LPA), which is flexible in its methods, depending on each individual case. In 2000, eight small, four medium-sized, but no large state-owned companies were privatised. In addition, a 27 per cent stake in the gas utility AS Latvijas Gaze (Latvian Gas) was successfully sold in March 2000 for US$ 47 million to the existing strategic investors. The state retained a 10 per cent stake and sold a further 2 per cent of the state holdings in late 2000 (see *Major sectors of the economy: Energy* below). The restructuring of Pirma Latvijas Komercbanka (First Latvian Commercial Bank), the former Rigas Komercbanka, was completed in May 2000 with the sale of stakes by the EBRD and other major shareholders to Norddeutsche Landesbank (Nord/LB, Germany, see *Financial sector* below). The private sector now accounts for around 65 per cent of GDP.

Although 97 per cent of planned privatisations have now been completed, the privatisation of the three remaining large-scale enterprises (the Ventspils Nafta oil terminal, Lattelekom and the Latvian Shipping Company) has been delayed. The new government has agreed that international advisors, selected through public tenders, are to be involved in advising the government authorities on each remaining large-scale privatisation.

In November 2000 the Saeima extended the validity of privatisation and property compensation vouchers by one year, to 31 December 2001. The voucher scheme was introduced in the early 1990s, and 76.4 per cent of the value of vouchers had been redeemed by 1 July 2000. The extension was required owing to the delays in apartment privatisation and privatisation of the remaining majority state-owned firms.

The largest enterprise, oil terminal **Ventspils Nafta**, represents a considerable share of Latvia's GDP. After an attempt to sell a 5 per cent share on the local stock market in May 2000 failed because of the high minimum price and the small size of the stake, the state decided to divest all of its 38.62 per cent of Ventspils Nafta's shares. From a shortlist of potential advisors selected through an international tender the LPA selected Raiffeisen Investment (Austria) at the end of 2000 and the sale of the stake is due to go ahead this year. (See *Major sectors of the economy: Transport* below.)

In February 2000, the Latvian government approved a plan for the restructuring of electricity monopoly **Latvenergo** by the end of the year and the privatisation of some of its constituent parts in the first quarter of 2001. In August, however, parliament adopted amendments to the energy law blocking the sale of any part of Latvenergo, retaining it as a vertically integrated company for the time being. In recent statements, the minister of economy has at least called for the internal restructuring of Latvenergo and the liberalisation of the power market, which will be necessary for EU accession. (See *Major sectors of the economy: Energy* below.)

The sale of the government's 51 per cent stake in telephone company **Lattelekom** has been delayed until the government succeeds in renegotiating the end of the fixed-line monopoly with Tilts Communications (Denmark), which owns the remaining 49 per cent. In September 2000, a consortium led by Chase Manhattan (US) was confirmed as the advisor to the privatisation. (See *Major sectors of the economy: Telecommunications* below.)

Attempts to privatise 44 per cent of the **Latvian Shipping Company** (LASCO) failed for the third time in March 2000 because the investor was not allowed to acquire a controlling stake and the government was to retain a golden share. In August 2000, a consortium led by auditing company BDO was confirmed as the advisor to the privatisation. In the new tender, elaborated together with the World Bank, announced in December 2000 and expected to take place by May 2001, the LPA offered 68 per cent to the potential investor, while 6 per cent was to be sold to staff and 15 per cent should be offered publicly against privatisation vouchers. In February 2001 the government included three companies in the long list of prospective bidders. (See *Major sectors of the economy: Transport* below.)

## Markets and trade

While domestic demand has been sluggish but increasing slowly, foreign trade recovered in 2000. Exports increased in 2000, and there was a further reorientation of exports to the EU, which started in 1999. According to the Central Bureau of Statistics, exports to the EU in 2000 increased to account for 65 per cent of total exports in value terms, at the expense of exports to the CIS that accounted for 8.7 per cent. Imports from the EU grew 7.9 per cent, while imports from the CIS (mainly Russia) increased by 26.8 per cent. Mineral products accounted for the bulk of these Russian imports.

Regional trade co-operation has increased further, both with the other two Baltic states and the Nordic countries. Lithuania and Sweden are among the five major trading partners. In 2000, the UK, Germany and Sweden were the main export destinations for Latvian products, while Germany, Russia and Finland were among the main sources of imports.

Latvian legislation in the area of customs is gradually being aligned with the *acquis.* The 1997 Customs Law was last amended in October 1998 with regard to duty relief and temporary imports. Several government regulations were adopted in the years after, such as a specific regulation on measures of customs authorities for the protection of

**Major export partners,** 1999 and 2000

| Place | | Country | Value, LVLm | | % of total | | % increase |
|---|---|---|---|---|---|---|---|
| 1999 | 2000 | | 1999 | 2000 | 1999 | 2000 | |
| 2 | 1 | UK | 165.838 | 196.490 | 16.4 | 17.4 | 18.5 |
| 1 | 2 | Germany | 169.984 | 194.288 | 16.9 | 17.2 | 14.3 |
| 3 | 3 | Sweden | 107.621 | 122.523 | 10.7 | 10.8 | 13.8 |
| 4 | 4 | Lithuania | 75.905 | 85.749 | 7.5 | 7.6 | 13.0 |
| 6 | 5 | Denmark | 61.667 | 65.882 | 6.1 | 5.8 | 6.8 |
| | | EU | 630.655 | 730.956 | 62.5 | 64.6 | 15.9 |
| | | CIS | 121.205 | 98.255 | 12.0 | 8.7 | -19.9 |
| | | **Total** | **1008.333** | **1131.315** | **100** | **100** | **12.2** |

**Major import partners,** 1999 and 2000

| Place | | Country | Value, LVLm | | % of total | | % increase |
|---|---|---|---|---|---|---|---|
| 1999 | 2000 | Group | 1999 | 2000 | 1999 | 2000 | |
| 1 | 1 | Germany | 261.297 | 302.601 | 15.2 | 15.7 | 15.8 |
| 2 | 2 | Russia | 180.971 | 224.459 | 10.5 | 11.6 | 24.0 |
| 3 | 3 | Finland | 156.876 | 167.064 | 9.1 | 8.6 | 6.5 |
| 4 | 4 | Lithuania | 126.335 | 146.446 | 7.3 | 7.6 | 15.9 |
| 5 | 5 | Sweden | 124.847 | 130.447 | 7.2 | 6.7 | 4.5 |
| | | EU | 940.166 | 1014.082 | 54.5 | 52.4 | 7.9 |
| | | CIS | 258.314 | 327.488 | 15.0 | 16.9 | 34.0 |
| | | **Total** | **1,723.9** | **1,933.9** | **100** | **100** | **12.2** |

*Source: Central Statistical Bureau, February 2001*

intellectual property, which entered into force in June 1999 and allows for the confiscation of counterfeited and pirated goods.

As Latvia is an important transit link between east and west, the government has given priority to the simplification of customs procedures. Under the Customs Law, special customs procedures are applied to the release of goods for free circulation, temporary import or export, customs warehousing, import to duty-free shops, inward and outward processing, export, transit etc. Customs duty is not applied on vehicles used in international transport, transfer of Latvian and foreign currency and securities, goods in transit through Latvia, goods imported into or exported from customs warehouses or inland customs zones, foreign investment in the form of fixed assets, mass media, non-commercial personal goods or property with a value of up to LVL 300, etc.

Latvia became a member of the WTO on 10 February 1999 and has committed to bind its tariff schedule on agricultural products at a ceiling rate of 50 per cent (effective on the day of accession) and to reduce tariffs on exceptional items. It has also committed to introduce competition in telecommunications services by 2003. Export duties have been removed on all but four items. Treatment of imports versus domestic products has been harmonised.

In June 2000, Latvia lifted its pork market protection measures, which were introduced in June 1999 following the Russian crisis. It had imposed extra customs tax at a rate of 70 per cent. The measures were deemed to be temporary, but were extended in December 1999 for a period of two years. In their place, the government now provides around LVL 1 million in subsidies to pork farmers as of July 2000. Latvia lifted the measures in order to implement the agreement on mutual liberalisation of trade in agricultural products with the EU and to avoid counter-measures from neighbouring countries. Moreover, starting in April 2000, agricultural tariff rates were reduced in line with WTO commitments and all tariff rates above EU levels were reduced to EU levels.

Latvia entered the Agreement on the Baltic Common Transit Procedure in 1999. This agreement refers to export, import, and transit freight conveyed by road within the Baltic states. The agreement affects the preparation of customs declarations and the system of receiving guarantees. The agreement reflects the internal transit procedure maintained in the EU and will ease the way of the Baltic states to inclusion in the EU Convention of Common Transit Procedures. An agreement between Estonia, Latvia and Lithuania on a uniform transit procedure took effect on 1 January. It introduced uniform customs requirements for cargo in transit, so that different documents do not have to be produced and different procedures followed in each Baltic state.

Along with Estonia and Lithuania, Latvia is a member of the Baltic Free Trade Agreement (BFTA), which first came into effect in 1994 and is intended to be the first step in the formation of a customs union. Following agreement among all three states to accept free trade for all domestic products, the BFTA was modified and became law from January 1997. The agreement is the first of its kind, as it provides for completely free trade in domestically produced agricultural and food products before the formation of a customs union.

### Taxation and social expenditure

A 25 per cent **corporate income tax** is applicable to most enterprises. The tax law permits a transfer of losses from year to year within a five-year period. New provisions effective from 1 January 2001 enable loss carry forward in the case of reorganisations (mergers, acquisitions, de-mergers and spin-offs). This amendment, however, applies only to losses which arose after 1 January 2001. Another amendment to the corporate tax law, adopted at the end of 2000, provides improved tax breaks for large investments. Investors who commit at least LVL 10 million (US$ 16 million) over three years qualify for tax reductions equal to 40 per cent of the value of the investment during the next 10 years following the investment. The tax break does not apply to investments which already qualified under the Law on Foreign Investment, to investments in monopoly industries or to projects where competition would be distorted.

From 1 January 2001, a Latvian company purchasing real estate in Latvia from a non-resident has to pay 2 per cent **withholding tax** of the sale proceeds. Previously, it had to pay 25 per cent of the capital gain. The requirement for Latvian companies to withhold 10 per cent on capital gains on securities sold by non-residents has been removed. Latvian companies can now purchase securities from non-residents without withholding tax.

A standard rate of 18 per cent **VAT** applies. Fixed asset investments for manufacturing are exempt from VAT, as are goods for inward processing under customs control, temporary import, customs warehousing, and transit. New legislation on VAT took effect on 1 January 2001, bringing the law into step with EU requirements. The amendments introduced new and harmonised terms and definitions and cancelled some VAT breaks. Foreign companies providing international transport services are now able to gain VAT refunds for fuel purchased in Latvia. The new law also affects the leasing market, providing equal VAT conditions for all participants.

**Excise taxes** are levied on cigarettes, alcohol, beer, coffee, soft drinks, fuel, cars, and luxury goods. Excise tax on diesel, the highest in the Baltic region, was lowered by 23 per cent to encourage transit carriers to buy more diesel in Latvia, make the country more competitive and boost foreign investment. The excise duty on petrol will remain unchanged until 2003.

The Law on **Real Estate Tax** reduced the tax on land to 1.5 per cent on the cadastral value, and on buildings and construction to 1.5 per cent of net book value from January 2000. The law provides for real estate tax to be levied at a flat rate of 1 per cent of the cadastral value from 1 January 2002.

From 1 January 2000, employers are required to pay the equivalent of 26.09 per cent of their employees' salaries as **social security** contributions. An additional 9 per cent is paid by employees. By 2002, the total social security tax rate is expected to drop to 33 per cent.

In February 2000, the Saeima adopted the Law on State-Funded **Pensions** for the second pillar of the pension system. Contributions will be collected starting in July 2001, gradually rising from 2 per cent of income in 2001-06 to 10 per cent by 2010 with the first pillar being reduced accordingly. Participation in the scheme will be mandatory for those who are subject to state pension insurance and under the age of 30, but optional for those between 30-49 years. For the initial 18 months, the State Treasury will manage the accumulated capital, but starting in 2003 the management will be entrusted to private companies. However, in order to help ensure that the three-pillar system is financially sustainable, the government committed to submit additional amendments to the law to increase the pace at which the retirement age is raised, tighten the rules allowing early retirement and eliminate the current limits on pensions to working pensioners.


# Major sectors of the economy

***The transformation of the production structure has proceeded faster and further in Latvia than in most other former command economies, with a rapid growth of the service sector, at the expense of industry and agriculture. The service sector grew from less than half of GDP in 1992 to almost three-quarters in 2000. Latvia's location as a transit corridor for east-west trade has led to a rapid expansion in transport and communications. The information and communication technology sector has been particularly successful. Initially the financial and later the trade sector have also added considerably to the growth of services. The most successful export products are wood and wood products, machinery and equipment, metals, textiles, and food products.***

## Food processing

The food processing industry is the largest industrial sector in Latvia, accounting for 35 per cent of industrial output. High-quality local raw materials are available for the meat packing and dairy industries, and for fish and grain processing. Most sub-sectors are dominated by strong companies which enjoy exceptional reputations in the east European markets they traditionally serve. Aldaris (beer), Laima (confectionery), Gutta (fruit juices), Kaija (fish) and Lido (meat) are well-known brand names in the Baltic and Russian markets. The sector has attracted a large share of foreign investment. The food industry accounts for about 18 per cent of all joint ventures in Latvian manufacturing.

Most sub-sectors in the food industry were severely hit by the Russian financial crisis of August 1998, losing large shares of their traditional Russian markets. Until 1998, half the exports in the sector were destined for Russia. The various sub-sectors affected have since shown an uneven level of recovery. Some have successfully reoriented their exports to new (EU) markets, while others have had difficulty in obtaining export authorisation. The brewing industry, which barely suffered from the crisis, continues to be successful in all three Baltic states and is now mostly in foreign (Nordic) hands (see *Brewing and distilling* below). The meat processing sector is doing well as it provides a substitute for previous imports from the EU and has been able to restore part of its CIS market. Some sub-sectors, however, have not recovered from the 1998 setback: the fish-processing industry still operates at only 30 per cent of its pre-crisis capacity, and the dairy sector is troubled as well, due primarily to a decreasing supply of milk.

### *Brewing and distilling*

Brewing is the most dynamic sub-sector in the food industry. Latvia's breweries sold 13 per cent more beer in 2000 than in the previous year. As in the other two Baltic countries, Baltic Beverages Holding (BBH), the Scandinavian joint venture between Pripps Bryggerier (Sweden), Ringnes (Norway) and Hartwall (Finland), dominates the brewing industry in Latvia. Norway's Orkla, which owns half the shares in BBH, in May 2000 announced a merger with Carlsberg Breweries (Denmark), which also owns one fifth of Hartwall. BBH owns 75 per cent of Latvia's biggest brewery, Aldaris, which controls more than half of Latvia's beer market. Thus since 2000, Aldaris is effectively controlled by Carlsberg. The remaining 25 per cent of shares belong to Aldaris' employees.

### Agriculture

The relative importance of agricultural production in the Latvian economy continues to decline. Agriculture's share of GDP fell from 21.1 per cent in 1990 to about 3.5 per cent in 2000. It remains inefficient, owing to the small size of farms and delayed land privatisation, and survives through the protection of high tariff barriers. Latvia continues to implement its national Support Programme for Agriculture. At the end of 1999 a Rural Support Service was set up to manage both national agricultural support programmes and to act as the implementation and paying agency for EU SAPARD (Special Accession Programme for Agriculture and Rural Development) funds. Under a Rural Development Project, the World Bank is helping to raise income levels and employment in the most depressed rural localities by stimulating entrepreneurial activities and providing support through a commercial credit line. Although agriculture accounts for only a small percentage of GDP, it employs about 15 per cent of the total workforce. The sector also remains relatively important in terms of trade. The main agricultural products are milk, meat, grain, sugar-beet and vegetables.

The restitution of private land to the original owners has led to the creation of a large number of family farms of small size. Land registration still continues, with registration in the Legal Register relatively low. The delays in processing land titles have constrained the development of the land market. Existing restrictions on foreign ownership and acquisition of land were abolished in 1999 in accordance with the Europe Agreement.

The company's sales increased considerably in 2000. Aldaris, which apart from beer also produces soft drinks and mineral water, on 7 September 2000 officially opened a Pepsi production plant with an output capacity of 35,000 litres an hour. Aldaris will invest more than LVL 4.5 million (US$ 7.4 million) to complete the production line. In this way Aldaris acquired the exclusive right to sell PepsiCo's (US) soft drink brands in all three Baltic republics.

The other 17 breweries of the Latvian Brewers Union, which controls 95 per cent of the beer market, showed varied results in 2000. Cesu Alus (Beer from Cesis) brewery, majority owned by A. Le Coq, the Estonian subsidiary of Olvi OY (Finland), sold less beer in 2000 than in its record year 1999, when it introduced three new brands, Cesu Premium, Cesu Tumsais and Cesu Gaisais. Cesu is implementing a new production line, to be completed in 2001. This is the biggest investment project in Cesis since 1991, worth LVL 2 million (US$ 3.3 million). Bauskas Alus, which accounts for 5.4 per cent of the Latvian Brewers Union's production, posted the highest growth of all Union breweries.

After NTBDC had acquired the privatised distillery Latvijas Balzams in 1999, it merged it with sparkling wine producer Rigas Vini, and created the largest beverages producer in the Baltics. The reorganisation came into effect on 1 January 2000, when Latvijas Balzams took over all rights and obligations of Rigas Vini. There has been significant restructuring and change of production structure since. The new, enlarged Latvijas Balzams is now focusing on production of light alcoholic drinks. The company had been suffering from the fact that people have changed their drinking habits and now prefer light alcoholic drinks to spirits. Besides, the Latvian domestic spirits market was too limited for further expansion. In 2000 LVL 1 million (US$ 1.64 million) was invested in Latvijas Balzams, and 2001 will see the same amount of investment. Profits dropped, however, due to a decrease in the sales of both strong alcohol and sparkling wine.

## Forestry and wood processing

Forestry and wood processing have a long tradition in Latvia. Of Latvia's land area, 45 per cent is classified as forest, of which three-quarters are available for commercial operations. State-owned forests comprise 50.3 per cent of the total forest area, while the remainder is privately owned. Given the present forest area and harvesting practices, annual harvesting volumes of commercial wood are stabilising at a level of about 10 million cubic metres. Reforestation after harvesting is mandatory. Former state forestry companies have been privatised and a large number of new companies established. About 300 companies are now working under long-term agreements. A proportion of state forest fellings are sold at auction. The main species are pine (40.5 per cent), birch (24.5 per cent), spruce (19.8 per cent), white and black alder (8.1 per cent), and aspen (6.1 per cent).

The wood processing industry contributes some 1.5 per cent to Latvia's GDP. Timber and wood products maintain the leading position in Latvian exports, 38.8 per cent. The sector has not suffered from the Russian financial crisis of 1998 as its exports to the CIS are minimal. The main export markets are west European and Scandinavian countries. The UK is Latvia's largest market for construction timber, Sweden for pulp. Other strong markets for Latvian timber are Germany, France, the Benelux countries and the Near East. Exports of timber and processed wood increased by 14 per cent in 2000. The financial results of the wood-processing companies are, however, declining and competition from Russia is growing. A disadvantage for the Latvian wood industry is the high rate of the lat versus the euro, while Russia has a price advantage due to the rouble's devaluation following the 1998 crisis.

### Kraft Pulp Mill

The most significant investment project to date in the wood processing industry is the greenfield Kraft Pulp Mill project. The mill is to produce 600,000 tonnes of bleached softwood and hardwood kraft market pulp annually. In 1998 the Latvian government invited 30 potential strategic investors to participate in the project, and of five positive answers, a combined offer from Finland's Metsäliitto and Swedish forest group Södra was chosen. In cooperation with the Latvian state, these investors formed a project company, Baltic Pulp, to establish the new mill. Metsäliitto and Södra hold 70 per cent, and the Latvian state 30 per cent in the new company. At a total cost of about US$ 768 million, the project will be the largest ever industrial investment in Latvia and the second largest in the Baltics, and would create more than 700 jobs in Latvia. It will be located in Jekabpils. The mill should become operational in 2005. Metsäliitto insists the authorities must decide on a package of investment incentives before May 2001 if the project is to attract the necessary funds. Both Estonia and Lithuania have started competing pulp plant projects of their own.

Only five sawmills have an annual output capacity of 30,000-90,000 cubic metres, and 15 have a capacity of 15,000-20,000 cubic metres, while about 2,000 are small and produce from 500-10,000 cubic metres a year. Since entrepreneurs in the industry are focusing increasingly on value-added and higher margin products, consolidation is continuing and several small, inefficient sawmills are being closed or modernised. Lindex and Linda, two leading forestry-sector firms, have merged in order to boost competitiveness. Linda, whose largest owner is Baltic Fund 1 (US), has operations covering the whole timber-processing business, while Lindex is its export arm. Following recent reorganisation, a bourse listing on a Nordic or central European stock exchange is planned.

The Latvian wood-processing association, Latvijas Koks, comprises 34 companies. In 2000 the association increased turnover by 7.5 per cent. The largest wood processing companies are plywood producer Latvijas Finieris, furniture company Zunda Holding, chipboard and hardboard producer Bolderaja, sawmill Vika Wood, and Stora Enso Packaging (formerly Pakenso Baltica). Bolderaja was the second Latvian wood processing company to receive an ISO 9002 certificate. Stora Enso Packaging is a 100 per cent subsidiary of Scandinavian company StoraEnso, the biggest European pulp and paper concern. Apart from Riga, Stora Enso has production facilities in Estonia and Lithuania. Stora Enso doubled its Baltic production in 2000.

BSW Timber plc (UK) has invested LVL 8 million (US$ 13.1 million) in the construction of a modern wood processing enterprise in Latvia whose capacity will amount to about 100,000 cubic metres of various wood products. Construction of the enterprise in Stopini County, near Riga, was completed in June 2000.

## Information technology

The Latvian IT sector is developing very fast towards western standards, in terms of both technical and business infrastructure – much more rapidly than any other industrial sector. The most important target areas for development of the IT sector in Latvia in the short- to medium-term is software development outsourcing, including programming and infrastructure design. IT is an important focus for economic development for the government: the IT education budget was increased by 20 per cent in 2000, and from 2001 high-tech companies will get income tax allowances.

**E-commerce**

A meeting was held in November 2000, at which the ministers of economy and justice and other relevant officials discussed conditions for creating a favourable environment for e-commerce, and for establishing efficient cooperation between the responsible ministries in order to find ways of boosting e-commerce development. A draft law on electronic documents and signature was submitted to the ministries for discussion and may be introduced in late 2001, provided the required financing is secured.

Meanwhile, the largest banks started to offer electronic services in 2000 and all the leading banks offer telephone banking and Internet banking. Some are also developing mobile banking and WAP services for release in 2001. In 2000 Hansabank launched its Internet banking site Hanza.net. In October 2000, Vereinsbank Riga started offering its customers an electronic payment system, MultiWeb, a new product introduced by parent company HypoVereinsbank (Germany). Late in 2000, Pirma Banka launched its OptiPay product for enabling bill payments by Internet. Latvijas Unibanka cooperates with Hewlett Packard (US) and Telia Latvia (Sweden) to boost the development of e-business in Latvia. Since November, the “e-xtra” kit for launching e-business has been on sale: a computer with licensed software and Internet connection and free access to Unibanka’s “Ibanka” (Internet Bank). Parex Bank will introduce Internet banking services in 2001 and for this purpose has signed a software licence agreement with Brokat (Germany).

At the Baltic Insurance 2000 conference the impact of e-commerce on the structure of insurance companies was discussed.

In August 2000, Apollo, the Internet provider of national telecommunications operator Lattelekom, launched a service and information portal at ***www.apollo.lv***, which started offering e-commerce at the end of 2000.

Software development has grown to include over 100 companies, employing more than 4,000 qualified staff. Several leading IT companies are ISO certified. As the national economy develops and new technologies are introduced, demand for IT services in Latvia is growing. In 2000, software development and integration outsourcing have continued to grow. Microsoft and Hewlett Packard have their own offices in Riga.

International investors are showing growing interest in investing in advanced businesses in the Baltic region. In 2000, IT firms in Estonia, Latvia and Lithuania have enjoyed an unprecedented inflow of investments, about US$ 50 million, originating mainly from private equity funds. There are only six Baltic IT companies worth more than US$ 6 million, among which there are two Latvian software developers: SWH Technology and Dati Grupa.

**Dati Grupa** was the first Baltic IT company to receive the ISO 9001 certificate in the area of software writing from Lloyd's Register Quality Assurance in 1999. The company continued to develop rapidly in 2000. It has established two new subsidiaries, Datisens and Dati Servisa Centrs. The company received a US$ 500,000 investment from the New Economy Ventures private equity fund, which acquired 3 per cent of the company. The new investment will allow Dati to raise the number of marketing experts selling its services to western countries. The company's growth in the last two years (including a 51 per cent increase in turnover in 1999) was reached by launching new projects in Scandinavia and central Europe, as well as by expanding the volume of services provided in the Latvian market and raising production efficiency in the implementation of large software projects. Dati Grupa encourages development of the IT branch in Latvia and stresses that for this purpose education is crucial. It recommends that there should be 1,000-2,000 IT graduates each year. Dati has been acting as a guarantor for education loans extended by Hansabanka to IT students.

**Sybase**, a leading supplier of database software, is setting up a company in Latvia to coordinate operations, sales and marketing. Sybase Baltic, the Finnish subsidiary of Sybase Inc (US), has set up separate units in Estonia and Lithuania as well. Sybase aims to become the leading supplier of mobile and Internet solutions in the Baltic Sea region.

### Telecommunications

In line with the EU application process, the Latvian authorities have decided to speed up liberalisation through new telecommunications regulations, to introduce competition in fixed-line services and to sell the state's majority stake in Lattelekom.

National operator Lattelekom was established in 1994 as a joint venture between the Latvian state (51 per cent) and a consortium of European operators, Tilts Communications (49 per cent). Since the third participant in the consortium, Cable & Wireless (UK), was bought out in 1998, Tilts Communications consists of Sonera (Finland, 90 per cent) and the IFC (10 per cent), giving Sonera 44.1 per cent of Lattelekom.

When Latvia became a member of the WTO in February 1999, it was required to shorten the term of Lattelekom's fixed-line monopoly, due to run until 2013, to 1 January 2003. The government approved a telecommunications development policy that ensures free competition in all types of communications by the beginning of 2003.

In return for its fixed-line monopoly, Lattelekom was expected to ensure full digitalisation of the network within eight years. This target has become less feasible, partly due to delays in tariff reform. When Lattelekom wanted to increase tariffs to cover more residential line costs and in return planned to invest US$ 240 million through 2001, its plans were approved by independent regulator the Telecommunications Rate Council (TRC), then opposed by parliament, but finally approved again by the Constitutional Court.

Tilts Communications, which was initially promised the monopoly until 2013 but saw the term shortened to 2003, wanted to be compensated for losing 10 years of Lattelekom's monopoly. Negotiations between Tilts and the government on compensation were proceeding, when in August 2000 Tilts decided to take the government to the International Court of Arbitration for breach of its agreement. The government, in turn, submitted a counter-claim on the basis of non-implementation by the company of the agreed investment plan and failure to modernise the sector as committed.

In September 2000, a consortium led by Chase Manhattan Bank (US) was confirmed as the advisor to the privatisation of the government's residual majority stake in Lattelekom. However, sales of this stake will be delayed until the government succeeds in renegotiating the end of Lattelekom's fixed-line monopoly. An agreement with Tilts is expected by mid 2001.

State-owned electricity company Latvenergo (see *Energy* below) has announced the completion of its own telecoms network, which it says will allow it to compete in a liberalised market when Lattelekom loses its monopoly in 2003. Latvenergo launched its digital network loop on 28 November 2000 at a cost of US$ 6.3 million, after completing work on its telecommunications infrastructure in the north-east of the country. The network is expected to be fully digitalised later in 2001 and to be joined by optical links to the Estonian and Lithuanian electricity systems. There is a further plan to link the telecommunications networks of the energy systems of states situated around the Baltic Sea.

### *Mobile telecommunications*

Mobile telecommunications is a booming business. Latvia has a cellular penetration of 15 per cent, as compared with 35 per cent in Estonia and 60 per cent in Finland, so the potential is still huge. Latvia currently has two mobile operators, LMT and Baltcom. A tender for a third licence has been postponed and may go ahead once the legal dispute between the state and Tilts Communications is resolved.

**LMT** (Latvijas Mobilais Telefons, Latvian Mobile Telephone) is the oldest and largest mobile operator with about 270,000 subscribers, 11.42 per cent of Latvia's population. It launched its NMT network in 1992, a GSM 900 network in 1995, and a GSM 1800 network in December 1999. LMT invested a total of US$ 134.2 million in the first eight years of its existence. LMT is owned by Sonera (Finland, 24.5 per cent), Telia (Sweden, 24.5 per cent), Lattelekom (23 per cent), Latvian Radio and Television Centre (23 per cent), and VEF (Latvia, 5 per cent).

**Baltcom GSM**, the second largest mobile operator with about 131,000 subscribers, became operational in 1997. In autumn 2000, Tele2, a unit of NetCom (both Sweden) bought Baltcom from its previous owners, Western Wireless (US), Metromedia and the EBRD. NetCom paid US$ 227 million for Baltcom GSM, including US$ 53 million of Baltcom's liabilities. NetCom plans to invest a further US$ 50 million to extend its mobile coverage in the country and cut domestic service tariffs. A new GSM network will be created by 2002. Baltcom aims to capture half of the Latvian market. In addition to Baltcom GSM services, NetCom plans to offer other products with the Tele2 brand and intends to develop various new services, such as Internet portals, broadband Internet access, voice-over IP, call-centre services, online payments, e-commerce services, and fixed communication services as soon as Lattelekom's monopoly expires.

The government will hold a tender for a third generation UMTS licence in the spring of 2001. Both LMT and Baltcom are expected to take part in the tender. Mobile operator Radiolinja, part of the Elisa group (Finland), which is already active in the Estonian and Lithuanian markets, is considering participating. A pan-Baltic working group has examined the idea of offering one licence for all three Baltic countries to a single operator, but in its report in early 2001 advised against this.

### Machinery and engineering

The main products in the engineering sector are ships, castings, steel and aluminium alloys, tooling, electric and diesel trams, diesel generators, agricultural machines, fire-fighting equipment and a variety of household appliances.

During the 1990s, the engineering companies have been undergoing a process of downsizing, reorganisation and market reorientation from CIS to other (EU) markets. In employment terms, the sector is still dominated by a small number of large companies, such as RER, REBIR, RVR and the Daugavpils Chain-Drive Factory, but a wide range of mechanical engineering products and components are produced by about 400 SMEs. The large companies in the sector are struggling, but the medium-sized companies are growing and attracting foreign investments, especially from German medium-sized enterprises. Exports of machinery, mechanical devices and electrical equipment increased by 25.1 per cent in 2000.

The tooling industry is one of the most promising sub-sectors, already exporting most of its output for the automotive and household goods markets. ACOT Technologies is the biggest tooling plant in Europe employing more than 500 people. There are several other strong local companies with significant growth potential, such as Tehprojekts and Skantooling.

### Textiles

The textile sector is the oldest branch of Latvian industry. Textiles and textile products are the second largest export item after wood products, representing 14.0 per cent of total exports. The large majority of products are exported to the EU and the other Baltic states. The EU imposes no quotas on textile exports from Latvia. Germany, Denmark and Sweden are the main export markets, with rapidly growing exports to France, the Netherlands, Portugal, Spain, Italy and Greece. The main sub-sectors of the Latvian textile industry are sewing, manmade filaments, wool, cotton and industrial textiles. The flax linen sector is relatively small but has huge potential for development. All these sub-sectors provide opportunities for foreign investment.

The sewing and work clothes sectors are the largest branches of the textile industry and offer the highest growth potential in absolute terms. The man-made filaments sector is the third largest branch. These sectors have attracted the largest amounts of FDI in the industry, from firms such as KGF, Konfektion AB, Snickers Europe AB, Swegmark AB (all from Sweden) and Steilmann (Germany). There are also numerous smaller foreign institutional and private investors from Sweden, Germany and the UK. Ninety five per cent of exports are to the EU.

The textile sector as a whole has been doing well in 2000. Exports increased by 2.1 per cent compared to 1999. The competitiveness of the textile industry has been preserved, due to the fact that real wages in the sector have risen in line with productivity. The competitive cost advantage is slowly disappearing and competition from China and India is likely to grow further.

### Retail

The recent shopping-centre boom in the Baltics continues. Construction of a new retail and recreation mall in Riga is to be completed by the spring of 2002. Located on the territory of the former VEF electronics factory, the new centre will have the first hypermarket in Riga with a covered trading space of 7,000-8,000 square metres. It will also include four or five specialised stores, a gallery of stores with 70-80 small shops, seven or eight cafes and restaurants, 10 cinemas and a recreation area located on 46,000 square metres. The centre will have parking space for up to 1,900 vehicles. A total of US$ 58 million will be invested in the project, of which US$ 10 million has already been invested. Construction began in the spring of 2001. Due to the mall's favourable location in Riga, it is calculated that 600,000 capital dwellers can reach it within 20 minutes.

Retailers Stockmann and Rautakirja (both Finland) plan to build a US$ 40 million shopping centre in Riga once all the approvals necessary for the deal have been received.

Baltic Food Holding (Sweden/Norway), a food retail and wholesale chain which has been rapidly expanding in the Baltics, in 2000 added 15 more shops to its existing total of 65 shops and two wholesale companies in Estonia and Lithuania, together with a distribution centre in Latvia. The main shareholders are Selvaag Gruppen (Norway), the Norwegian Government Regional Development Fund, Axfood AB (Sweden), and the managing director and the chairman of the board who set up Baltic Food Holding in 1995. Financing of € 12.1 million from the EBRD is enabling Baltic Food Holding to develop its retail and wholesale activities in Latvia, Estonia and Lithuania by acquiring new supermarkets, upgrading its existing stores and expanding wholesale operations. The financing consists of € 6.6 million to Baltic Food Holding Estonia and a € 5.5 million equity investment in Baltic Food Holding AS, which is based in Norway. The project will enable the company to expand even faster and become one of the main players in food retail and wholesale in all the Baltic countries.

### Transport

The geographic location of Latvia, traditionally and naturally, has given it strategic hub status as the gateway to Russia, and the importance of its transport, distribution and transit sector is demonstrated by the GDP it generates. Latvia recognises the need to play a vital part in the development of the EU's integrated Trans-European Network (TEN), which embraces the EU member countries, and through the development of the so-called Pan European Transport Corridors will come to include the accession countries and the rest of eastern Europe. Against this background Latvia is investing heavily in its multi-modal transport and distribution infrastructure, to maintain and develop its vital link in the transport network between east and west. In this framework, the Latvian government has developed several specific plans of action, such as the Programme for Port Development.

#### *Sea ports and shipping*

In terms of freight volume Latvian ports are the second largest in the region, after Finland's. Latvia's strategic hub status is ensured largely by its three major ports, Riga, Ventspils and Liepaja. Ventspils and Liepaja are ice-free all year round, and Riga operates with the help of an ice-breaker in severe winters. A US$ 545 million Programme for Port Development has been designed to meet the needs of expanding east-west trade. Parts of this programme have been or are being financed by IFIs.

**Ventspils Free Port** is the biggest port in the Baltic states and among the 15 biggest in Europe. It covers an area of 1,600 hectares of which 1,300 is on land. The overall length of the quay is almost 10,500 metres with berthing facilities for nearly 70 vessels. Most of Ventspils' activity is east-west export trade from Russia. Ventspils is seeking to develop import trade, particularly from Europe and the US, and is keen to attract western-based partners to develop further its ro-ro and

**Ventspils Nafta**

Ventspils is the terminus of an oil pipeline network originating from Russia with a main pipeline carrying crude oil and a subsidiary pipeline carrying oil products. Oil terminal Ventspils Nafta represents a considerable share of Latvia's total GDP. Ventspils Nafta's capital is more than LTL 200 million (US$ 328 million). The terminal handles a quarter of all Russia's oil trade. Russian oil company Lukoil is one of the main users of the port, shipping around 2.5 million metric tonnes of crude oil and other oil products annually through the terminal. Ventspils Nafta is building new storage tanks and other facilities worth US$ 150 million to further increase its handling capacity.

Ventspils Nafta's privatisation is being carried out in several rounds. In October 1997 newly created Latvijas Naftas Tranzits (Latvian Oil Transit, LNT) bought the state's share in LaSaM, the Latvian participant in the Latvian-Russian joint venture LatRosTrans, which operates the oil pipelines that supply Ventspils. LaSaM then merged with Ventspils Nafta. In this way, the terminal became owner of the pipeline, and LNT gained a 37 per cent stake in Ventspils Nafta. Of the remaining state-owned shares, 20.5 per cent was sold by public offering (15.5 per cent for privatisation vouchers, 5 per cent for cash). The next stage of the privatisation was to involve further public offers to privatise two small stakes, and the state would be left with a 26 per cent share.

In May 2000, the Latvian Privatisation Agency decided to reverse this plan after an attempt to sell a 5 per cent share on the local stock market failed because of the high minimum price and the small size of the stake. Instead, the state decided to divest all of its 38.62 per cent of Ventspils Nafta's shares. From a shortlist of potential privatisation advisors in an international tender the Privatisation Agency selected Raiffeisen Investment (Austria) in December 2000.

container trade. Oil and oil products account for over 70 per cent of cargo turnover. Ventspils port houses the largest oil and oil-products transit terminal in the Baltics, Ventspils Nafta (see box). In addition to oil and oil products, the port also has dedicated facilities for handling chemicals, potassium chloride, metals, cotton and timber. There are chemical cargo and potassium-salt terminals; Ventspils is one of the biggest handlers of potassium in the world.

About US$ 330 million has been and is being invested in Ventspils port between 1996 and 2001. Among recent improvements is an expansion of the area and depth of the navigation canal and ship-turning basin. This has opened the port up to the transatlantic market by giving access to larger long-haul tankers. In addition, there has been a reconstruction of general cargo quays, expansion of the potassium-salt handling complex and of oil pier number 1 to allow 150,000

Attempts to privatise 44 per cent of the **Latvian Shipping Company** (LASCO) failed in March 2000 for the third time in three years, when the only bid submitted was rejected by the Privatisation Agency as not being in compliance with privatisation regulations. Interest was apparently low because the privatisation did not allow an investor to acquire a controlling stake and the government was to retain a golden share. Finally, a decision was taken to sell a majority stake of the company and an international consortium of advisors was hired to advise on the sale in September 2000. The plan was elaborated together with the World Bank. In the new tender, announced in December 2000 and expected to take place by May 2001, the Privatisation Agency offered 68 per cent of the share capital or 136 million shares to the potential investor. Of the remainder, 15 per cent should be offered publicly against privatisation vouchers in May, 10 per cent will be transferred to the national pension budget, 6 per cent should be sold to current and retired employees, and 1 per cent will be set aside as a privatisation reserve. However, the privatisation may well be complicated by the as yet unsettled issue of payments allegedly owed by LASCO to Gdansk shipyard in Poland. In February 2001 the government included three companies that had sent in their expressions of interest in the long list of prospective bidders.

While the rules for the new tender were being drafted, the Privatisation Agency gave permission to sell seven refrigerator vessels as part of LASCO's strategy to focus on its core tanker business, and backed LASCO's plans to buy or build six new tankers to replace older vessels and boost competitiveness. LASCO, the ninth largest merchant fleet in the world, owns a large fleet of vessels including tankers, reefers, LPG carriers and dry cargo vessels. The company provides commercial and technical management, as well as crewing for the fleet and other ship owners. LASCO offers a liner service between northern Europe and Russia via the Baltic ports and several different kinds of sea transportation services.

tonne tankers to be loaded. Once these projects are completed, the port should reach a total annual capacity of 80 million tonnes.

SIA Noord Natie Ventspils Terminal (NNVT), a joint venture of stevedoring firm Noord Natie NV ( Belgium) and Ventplac LLC, a group of several Latvian entities, is building a new multi-purpose terminal in Ventspils, which will provide a junction for different modes of transport. It will be able to serve the growing demand for general cargo traffic in the Baltic Sea, particularly containers. The project is structured as a Public-Private Partnership between NNVT and the Ventspils port authorities with a total cost of approximately US$ 75 million, with the port authorities providing US$ 43 million of public sector financing. The infrastructure required in order to start operations, was co-financed by the EIB in an amount of € 20 million. A US$ 21.2 million EBRD/KBC Finance (Ireland) loan is being used to part-finance NNVT's US$ 32 million investment programme as a private sector contribution to the PPP, and in particular to finance the purchase and installation of cargo handling equipment and other superstructure. The first part of the Noord Natie Ventspils container terminal was officially opened on 6 October 2000. Noord Natie is considering bids to construct two more piers at a cost of US$ 30 million.

**Riga Port** is the second largest port, covering 2,500 hectares with 10,500 metres of berthing space and a 12-metre draught. The outer regions of the port are being dredged to a draught of 14 metres. Eighty five per cent of the cargo is in transit to and from the CIS. The port also embraces Riga Commercial Port, which handles most of Latvia's container traffic at its 200,000 TEU capacity container terminal. More than 60 companies are located in Riga Port, providing all essential associated services. Both short and long-term investment is being made in infra- and superstructure as part of the Programme for Port Development. Plans are being developed for a Distripark offering a reliable, simple and fast customs handling facility and transit services to the Russian border. Facilities would also include high-quality warehousing and distribution and a capacity for value-added activities. Container volumes at Riga's Baltic Container Terminal started to recover at the end of 2000 following a slump in 1999 as a result of the Russian crisis. Business was boosted by the addition of new services from global carrier Mediterranean Shipping Company.

**Instrument for Structural Policies for Pre-Accession (ISPA) funding**

On 1 December 2000 EU and Latvian officials signed a memorandum of understanding on the EU structural fund ISPA. The memorandum enables Latvia to enter into agreements and launch the implementation of investment and technical assistance projects, with the co-financing of ISPA, in the environment and transport sectors. The European Commission has so far approved three environment and four transport infrastructure projects to which nearly € 81 million have been extended from the ISPA fund while Latvia's co-financing for the projects will be € 40 million. In order to implement the projects, a financial memorandum will be agreed for each project. The projects have to be pre-financed by Latvian authorities or companies and will be repaid from 47 to 75 per cent by ISPA. Implementation of the first project in Latvia began in April 2001. This project involves the improvement of the Via Baltica highway between the thirteenth and twenty-first kilometres. Total costs amount to € 6.25 million, of which ISPA will cover € 4.69 million. The most expensive project is expected to be the east-west railway corridor reconstruction, which will cost an estimated € 35.24 million, of which ISPA is expected to contribute € 26.43 million.

**Liepaja**, the former home of the main Soviet Baltic Fleet outside Russia, is now developing as a multifunctional commercial port, used for timber and metals and ro-ro cargo handling. The port's capacity is expected to increase to 14 million tonnes when major improvements totalling more than US$ 30 million under the Programme for Port Development are completed. These include improved infrastructure and superstructure, the dredging of harbour basins, a new US$ 3 million breakwater, a major highway from the port and improved railroad and marshalling yards. As a new harbour, Liepaja can implement very efficient, flexible development policies specifically designed to attract and encourage investment.

### *Railways*

Of all transit cargo through Latvia, some 80 per cent enters by rail, while a similar proportion leaves by sea. As transit cargo accounts for 78 per cent of the total, maintenance and development of railways is a priority. Of the total 40 million tonnes of rail cargo, 70 per cent originates in Russia, making development of the east-west corridor especially important. The east-west transit corridor links Moscow with Ventspils Port, with two major branch lines to Riga and Liepaja. The other major rail-freight corridor runs north-south, linking Latvia with St. Petersburg and Warsaw. Almost all of Latvia's 2,413 kilometres of railway track is wide gauge, compatible with that used in Russia and the other CIS countries, but not adjusted to the west European standard, which is a constraint on its integration into the European railway network.

An extensive US$ 750 million expansion and modernisation programme is currently being carried out with IFI financing. The EBRD and EIB are co-operating on the project, for which the Latvian authorities have also applied to the EU for grant financing for selected track renewal components on the east-west corridor. Further development of the north-south corridor is presently under way in co-operation with the neighbouring countries. The Balt Rail 2000 project is playing a significant part in the railway development programme. Investments will also be made to improve the Jelgava-Liepaja line and the Ventspils and Liepaja port railway junctions, and to develop port access roads and infrastructure.

The state-owned railway company Latvijas Dzelcelsh (LDZ) currently carries about 40 million tonnes of freight, but plans to increase cargo volumes on the east-west corridor to 60 million tonnes by 2010. Oil and oil products make up almost half of the cargo carried by LDZ. Other major cargoes include chemicals and fertilisers, ferrous metals, and timber. An automatic tracking information system ensures efficient control of freight operations. There is a special shuttle block-train service between Riga Commercial Port and Moscow Container Terminal with a journey time of 40 hours door-to-door. Freight tariffs are determined in accordance with the Combined International Transit System.

The Railway Law, which is generally in line with EU directives, came into force in November 1998. It includes the separation of regulatory from operating responsibilities with the appointment of an independent regulator; rights of access to rail infrastructure by third party train operators; the establishment of a Railway Fund to finance railway infrastructure; and the introduction of public service contracts to end cross-subsidies from freight and to create transparent compensation mechanisms. In accordance with an EU directive, LDZ has been divided into five operating units: infrastructure, rolling stock, real estate, freight and passenger transport. Services may be privatised, but the state will maintain the infrastructure.

### *Road network*

Latvia has more than 20,000 kilometres of well-developed road network, of which more than 1,600 kilometres are defined as main roads. The most important transport corridors are the east-west corridor connecting major ports Ventspils, Riga and Liepaja with Moscow (Via Latgale), and the north-south corridor which links Helsinki and Tallinn with Kaunas and Warsaw (Via Baltica), with a branch to Kaliningrad and Gdansk. The connecting roads of the east-west corridor provide links between Pan European Transport Corridors I, II and IX, and the north-south corridor is part of Corridor I.

The Via Baltica five-year investment programme sponsored by IFIs provides US$ 30 million of funding within Latvia. Two new sections of the Via Baltica were officially opened at the end of November 2000, marking the completion of the first stage. The project costs were provided by the State Road Fund, the EIB, the Northern Investment Bank, JEXIM Bank (Japan), and the EBRD. The State Road Fund was established in 1994 to provide the financing for repair, maintenance and development of the road network. Government-guaranteed loans have been secured from the EBRD (US$ 10.4 million), JEXIM (US$ 20.8 million) and the World Bank (US$ 20 million) for the maintenance and development of the state road network.

### *Aviation*

Latvia's aviation sector is dominated by Riga International Airport, the biggest and busiest airport in the Baltic states, which handles 99 per cent of all passenger and freight traffic in Latvia. The airport has one of the most modern and technically well equipped air traffic control centres in Europe, responsible for about 100,000 aircraft movements within its controlled airspace, and is a member of Eurocontrol (an association of co-operating European air traffic control centres). In addition, there are regional airports at Liepaja, Ventspils and Daugavpils, handling a small proportion of international charter flights.

Latvia's national airline and flag-carrier is Air Baltic, jointly owned by the Latvian government and SAS (Scandinavian Airlines, 38 per cent). Air Baltic operates direct scheduled services to Copenhagen, Stockholm, Helsinki, Kiev, Frankfurt, Budapest, Vilnius, Warsaw and Tallinn. Air Baltic carried 10 per cent more passengers in 2000 than in 1999.

## Energy

The energy law, adopted in September 1998, provided the regulatory framework for the energy sector, including rules for licensing and establishing new generation capacity. The law also provided a framework for transparent pricing and for the activities of the quasi-independent Energy Regulation Council (ERC).

Latvenergo, the integrated state energy monopoly, was to be privatised by the middle of 1998, but a lack of political consensus over its restructuring and the privatisation method to be used contributed to long delays. In the spring of 1999, the government proposed unbundling the sector under a holding company structure that would remain majority state-controlled. In February 2000, the government approved a plan for the restructuring of Latvenergo by the end of the year and the privatisation of some of its parts in the first quarter of 2001. According to the plan, the hydropower stations and high voltage network would remain in state hands, while stakes of up to 49 per cent in the thermal power stations would be sold. Although the low-voltage distribution network was not to be sold, the plan did allow for private companies to take over maintenance of the network and purchase and sale of energy.

However, 23 per cent of eligible Latvians signed a petition for a referendum against privatisation and in August 2000, in accordance with the results of the referendum, parliament adopted amendments to the energy law blocking the sale of any parts of Latvenergo, retaining it as a vertically integrated company.

### *Gas*

A 27 per cent stake in gas utility AS Latvijas Gaze (Latvian Gas) was auctioned in March 2000 for US$ 47 million. Most of the existing strategic investors were successful in increasing their respective stakes. The state retained a 10 per cent stake. The Latvian Privatisation Agency approved the auction of a further 2 per cent of the state shareholding in December 2000. As a result of the sales, Ruhrgas (Germany) now owns 25.6 per cent, Gazprom (Russia) 25 per cent, Itera (Florida-based, but widely believed to be closely linked to Gazprom) 22.5 per cent, Preussen Elektra (Eon, Germany) 17 per cent, and Fortum Gas and Oil (Finland) has a 1.9 per cent stake. Latvijas Gaze now has a sound strategic ownership structure and restructuring is going well.

Latvijas Gaze intends to cancel tariff discounts for large industrial and municipal users, as the price at which it purchases natural gas from Russia has increased roughly 15 per cent in 2000. The maximum price would still not exceed the limit approved by Latvia's energy supply regulation council of LVL 60.7 (US$ 97.02) per 1,000 cubic metres. The company has also submitted proposals to the council to increase the tariffs for industrial users by between 5 and 10 per cent, but approval for this was denied.

# Riga Water Company (Rigas Udens)

Riga Water Company (RW) is a water utility wholly owned by the City of Riga. It has existed as a separate company for 40 years, and was incorporated in its current form as a municipal enterprise in August 1996. The company is overseen by a seven-member Supervisory Council comprised of Riga City Council members and one water utility expert. RW serves approximately 716,000 customers in the Riga area, and employs 1,400 staff.

In August 1996 the EBRD signed a loan agreement with RW for € 26.0 million. The loan proceeds are being invested in the rehabilitation and construction of municipal water and wastewater infrastructure. Construction is progressing well and by the end of 2000 € 13.8 million of the loan had been disbursed. The EBRD loan benefits from a sovereign guarantee and RW is in compliance with all loan covenants. The EBRD loan represents 19 per cent of the total project costs which amount to more than US$ 121.2 million. The project is co-financed by the EIB (16 per cent), international donors (10 per cent), the state of Latvia (3 per cent), the City of Riga (16 per cent) and RW cash-flow (37 per cent).

As part of the EBRD project, RW received a four-year training programme from Stockholm Water Company to strengthen operational performance. This twinning programme was paid for by the Swedish International Development Agency (SIDA). A long-term asset maintenance and replacement plan was drawn up and is being implemented. Tariffs were reformed to achieve full cost recovery and eliminate cross-subsidies between customers. The management of the company is satisfactory and a peer group analysis shows that RW is one of the best performing water utilities in the Baltic region, although there remains room for improvement.

As part of its EU Accession Strategy, the Latvian Ministry of Environment has identified further improvement of Riga's water services as a national priority. To meet this objective RW has approached the EBRD, the EU, and the EIB for assistance to prepare and finance a second phase of water and wastewater investments. In autumn 2000, the EBRD made a loan of € 39 million to RW to further improve the municipal water and wastewater system. RW is the first local service utility in Latvia to receive a direct corporate loan from an IFI.

Under a creative structure that could be the benchmark for other municipal borrowers, the loan is backed by an undertaking of municipal support, but not a financial guarantee, by the city of Riga. The loan is for re-financing of the existing sovereign-guaranteed loan to transform it into a € 24.8 million corporate loan and for co-financing of additional ISPA-related and other investments. This project demonstrates to other cities and banks that municipal services can be financed without recourse to sovereign or full municipal guarantees.

The project aims to improve the supply and installation of water meters, the rehabilitation of treatment plants, pumping stations, water wells and networks. In addition, completion of the Daugagriva WWTP sludge deposit and extension of the sewerage network in the city of Riga are also objectives of the project. The project has mainly environmentally related objectives and will help RW to achieve compliance with EU directives. It will contribute to a reduction in the manganese content in the drinking water, and the rehabilitation of the sewerage network will reduce sewage leakage.

Part of the loan will be used to form centralised canalisation systems, to improve the quality of the drinking water, and to improve water supplies and cleaning of drainage water in Riga. Water consumption rates will be increased annually to repay the previous loan. It is likely that water rates will increase even more after 2005 when the repayment of the new credit starts.


# Financial sector

***The financial sector in Latvia recovered remarkably quickly from the serious consequences of the Russian financial crisis of 1998. The banking sector is now in healthy shape. Restructured Pirma Latvijas Komercbanka was sold to a strategic investor in spring 2000. The securities market is further integrating into the Baltic and Nordic region. Latvia is the first of the three Baltic republics where private pension funds, owned by the large banks, are developing satisfactorily. The insurance market is consolidating and attracting considerable foreign investment. Latvia's major leasing companies have formed a new association.***

In May 2000, the parliament adopted a law for consolidated financial sector supervision. The Finance and Capital Markets Commission is due to take over the supervision of brokerages, insurers, credit institutions, investment funds, private pension funds and other financial market participants in July 2001. The Commission will have considerable independence by setting its own budget and raising its own revenue from fees paid by market participants. The chairman and deputy chairman of the Commission are nominated by the central bank (Bank of Latvia, BoL) and the Ministry of Finance, and approved by parliament.

## Banking sector

The banking sector underwent significant transformation following the banking crisis of 1995, when less competitive banks went out of business and the BoL embarked on a series of reforms and actions to develop supervisory and regulatory systems. The BoL has gradually brought its prudential regulations close to full compliance with the Basle Core Principles on Effective Banking Supervision and the relevant EU directives. The bank regulatory framework is now predominantly based on EU standards and Latvia complies with most of the major European banking regulations. IAS accounting and audit by international firms are obligatory for all banks in the country. A deposit insurance scheme has been introduced in order to restore depositors' confidence and develop the banking market.

### *Bank consolidation*

The Latvian banking system was more severely affected by the Russian financial crisis of 1998 than banks in the other two Baltic states. Rigas Komercbanka, the country's third-largest bank at the time, was declared insolvent and closed in March 1999. Following a successful recapitalisation the bank re-opened in October 1999 under the new name Pirma Latvijas Komercbanka (The First Latvian Commercial Bank). In May 2000, 90 per cent of the bank was sold to Norddeutsche Landesbank (Germany, see opposite). The minimum statutory capital for banks was raised to € 5 million from 1 January 2000. Increased competition and mergers – e.g. in early 2000, Hansabanka acquired Ventspils Apvienota Baltijas Banka – have led to further banking sector consolidation and have reduced the number of banks from 27 at the end of 1998 to 21 at the end of 2000.

**Restructuring and privatisation of Pirma Latvijas Komercbanka**

The restructuring of Pirma Latvijas Komercbanka (The First Latvian Commercial Bank), the former Rigas Komercbanka, was completed in May 2000 with the sale of stakes by the EBRD and other major shareholders to Norddeutsche Landesbank (Nord/LB, Germany). This transaction marked the conclusion of a remarkable restructuring of Rigas Komercbanka following its 1999 insolvency, and was brought about without any significant new cash contribution from the Latvian government.

The restructuring was led by the Bank of Latvia (BoL) and the EBRD, and was supported from an early stage by syndicates of creditor banks led by Fuji Bank (Japan) and Landesbank Schleswig-Holstein (Germany). All parties, including the BoL, the government, the bank syndicates, the EBRD and a large number of depositors, shared the burden of the restructuring and recapitalisation. A special-purpose subsidiary of the BoL was established and became the largest shareholder in the restructured bank. In addition to its initial equity investment in 1996 of US$ 5 million, the EBRD contributed US$ 4.5 million to the transaction in 1999 in the form of new cash equity.

The primary objective of the bank's rehabilitation was achieved when the bank re-opened under its new name in October 1999. Under the rehabilitation agreement, all the major shareholders, whose combined holdings exceeded 90 per cent of the voting shares of Pirma Latvijas Komercbanka, were to sell their shares to Nord/LB as the strategic investor. Nord/LB's acquisition of Pirma Latvijas Komercbanka represented the successful achievement of the second key objective in the bank's rehabilitation, namely, to attract a strong strategic investor. The rehabilitation of Rigas Komercbanka represents the first voluntary bank restructuring in Latvia, and possibly the first in central and eastern Europe. It greatly supported the transition towards a stronger bank and a stronger banking sector in Latvia.

A further strengthening of the sector occurred in the autumn of 2000 when Skandinaviska Enskilda Banken (SEB, Sweden) increased its stake in Latvijas Unibanka, the country's second largest bank, from 50.5 to 98 per cent through a cash offer for outstanding shares. SEB acquired full ownership of its subsidiaries in Lithuania (Vilniaus Bankas) and Estonia (Eesti Ühispank) in the same period, spending a total of US$ 210 million.

There are 21 licensed banks in Latvia. The reason for this large number is that there is a significant flow of funds to and from Russia and Ukraine via Riga and on to markets in western Europe and the US, which creates substantial business for a number of Latvian banks. All the Latvian banks were able to meet the minimum capital requirement of € 5 million on 1 January 2000. Further consolidation can be expected in 2001, achieved primarily through acquisitions.

In December 2000 Parex Bank, Latvia's largest bank, announced a substantial restructuring in advance of hoping to attract a strategic investor. Rietumu Banka and Saules Banka (owned by Estonia's Ühispank which in turn is owned by Sweden's SEB) have announced their intention to merge, potentially creating the fourth largest bank in the country.

**Foreign investment in the banking sector**

According to the 1995 laws on credit institutions and on the Bank of Latvia, a foreign bank opening a representative office or bank branch, or merging with a local bank must receive approval from the BoL. Swedish banks in particular (Skandinaviska Enskilda Banken, Swedbank, and Finnish-Swedish MeritaNordbanken), and German banks (Vereinsbank und Westbank, Norddeutsche Landesbank Girozentrale) are particularly active on the Latvian banking market. Islandsbanki-FBA (Iceland) has announced an intention to buy a 52.2 per cent stake in Rietumu Banka, Latvia's sixth-largest bank by assets, for US$ 27 million. The deal was completed in March 2001, after approval by the BoL was received, due diligence conducted and the acquisition agreed. Rietumu Banka intends to merge with Saules Banka, the fourth largest bank, which would raise its assets from US$ 206 million to US$ 450 million, making it the fourth-largest bank in Latvia. In addition to the Latvian market, Islandsbanki-FBA will gain access to business in Belarus, Kazakhstan, Russia and Ukraine through Rietumu's representative offices in Minsk, Almaty, Moscow and Kyiv respectively.

**Latvijas Unibanka SME Finance Facility**

Latvijas Unibanka, Latvia's second largest bank in terms of assets, was founded in September 1993 as a state-owned commercial bank, and was formed through the consolidation of a number of branches of the Bank of Latvia. It was partly privatised with EBRD support in early 1996 and its shares were listed on the Riga Stock Exchange. In early 1999, Skandinaviska Enskilda Banken (SEB, Sweden) bought the EBRD's stake in Latvijas Unibanka, in addition to a remaining state-owned stake and other shares in the market, and thus by mid 1999 had acquired a majority ownership of 50.5 per cent. In autumn 2000, SEB increased its stake in Latvijas Unibanka to 98 per cent through a cash offer for outstanding shares and did the same with its subsidiaries in Lithuania (Vilniaus Bankas) and Estonia (Eesti Uhispank).

In July 2000, a € 10 million six-year loan from the EBRD to Latvijas Unibanka was signed, which shall promote the growth of Latvia's small- and medium-sized enterprises (SMEs). The loan was the first extended to a Latvian bank under the SME finance facility for the 10 EU accession countries launched by the EBRD and the European Commission in April 1999. At the same time, Latvijas Unibanka benefits from a substantial technical co-operation package aimed at developing the bank's SME lending programme, as well as a grant to help cover the costs of building this business. Both are being funded by the Phare programme of the European Commission.

With a six-year maturity, the € 10 million loan allows Latvijas Unibanka to incorporate further lending to SMEs into its ongoing business. It also provides much-needed medium-term funding to SMEs to ensure the sector's further growth. EU-Phare's one-year technical co-operation programme for Latvijas Unibanka is being used to provide long-term credit advisors and experts in various fields, and also to cover staff training costs at the start of the lending programme.

This type of credit line is essential to address the lack of medium-term financing for small- and medium-sized businesses, and to promote their development in Latvia and other EU accession countries. As the largest lender to the Latvian economy, and with a country-wide banking network, Latvijas Unibanka is well placed to reach local SMEs throughout the country.

## Non-bank financial institutions

### *Stock exchange*

The Riga Stock Exchange (RSE) is the sole licensed stock exchange in Latvia. It is a non-profit joint stock company with major Latvian commercial banks and brokerage companies as shareholders. The RSE is a founding member of the Latvian Central Depository (LCD), which has been granted the status of National Depository and acts as a central bank for securities. The RSE offers its members a fully automated service for order execution. All laws and regulations on public trading comply with EU directives. At the end of 1999, changes in the legislation were adopted which significantly improved the protection of minority shareholders' interests. From the beginning of 2000, all trading of public securities in the Latvian capital market must be reported to the National Depository, and the RSE disseminates the volume data to the market. This system has added transparency to the market, as previously only the trading results of the RSE were disseminated.

In 1997, the RSE joined the Federation of International Stock Exchanges (FIBV) as a Corresponding Emerging Market. The small Latvian, Estonian, and Lithuanian stock exchanges realised that regional cooperation would be the best way for them to attract capital. The first concrete step was taken in July 1999 when the RSE and the Tallinn Stock Exchange began sharing real-time information on trading. At the beginning of 2000 the Latvian, Estonian, and Lithuanian stock exchanges launched the Baltic list, intended to package and market shares in the 15 largest and most widely traded Baltic companies. In May the RSE signed a letter of intent to join NOREX, the alliance of Scandinavian stock exchanges, as a fully-fledged member. Mid-2001 is mentioned as a target date for membership, however, membership during 2002 is more likely. In order to join, legislation in Latvia and Lithuania must be changed. At this moment, the alliance is only between Sweden and Denmark, but the Norwegian and Icelandic stock exchanges plan to join in 2001.

Companies on the official list of the RSE include insurance company Balta, Latvijas Gaze, ship builder and repairer RKBV, the Riga Transport Fleet, Staburadze cake and biscuits manuafacturer, Latvijas Unibanka, and Ventspils Nafta. The second list includes distiller Latvijas Balzams, pharmaceutical companies Grindex and Olaines, Gutta fruit juices, Kaija fish products, textile company Valmieras, and Pirma Latvijas Komercbanka. SEB (Sweden), owning 98 per cent of Latvijas Unibanka, has decided to delist the bank from the RSE in 2001.

### *Pension funds*

Following the enactment of a law on private voluntary pension funds in July 1998, Latvia is gradually moving away from the old pay-as-you-go system. Four private pension funds now hold licences. Atklatais Pensiju Fonds Baltikums (the former Saules Stars), Unipensija (81 per cent owned by Latvijas Unibanka) and Socialais Nodrosinajums (77 per cent owned by Parex Bank) are in early stages but are developing well. They are owned by the major banks through their asset management subsidiaries. The fourth private pension fund is Lattelekom Slegtais Pensiju Fonds. About 20 large Latvian companies introduced pension schemes for their employees in 2000.

### *Insurance*

The September 1998 insurance law strengthened the legal foundation of the Insurance Supervision Inspectorate (ISI), a quasi-independent regulatory body under the Ministry of Finance. The law restricts representative offices or branches of foreign insurance companies to engage in any insurance operation except reinsurance. However, a foreign insurance company is eligible to set up a 100 per cent foreign-owned insurance company in Latvia.

The insurance market is dominated by compulsary insurance of car owners' civil liability and business property insurance. There are now 12 insurance companies and the consolidation is continuing due to acquisitions by German and Nordic insurers. Three companies – Latva (95 per cent owned by Balta, the biggest insurance company in the Baltic states), Baltikums Dziviba and Alterna – account for two-thirds of all premiums collected. Alte Leipziger, a subsidiary of Muenchener Ruck (both Germany) bought 100 per cent of insurance companies Alterna and Alterna-Viva and 70 per cent of Latgarants in autumn 2000, while it already controlled Rigas Feniks and Rigas Feniks Dziviba. In October it announced that it would merge the five acquisitions to form a single new business with a market share of 21 per cent, creating the second-largest insurer in the country. In early 2001 Codan (Denmark) acquired 73.35 per cent of shares in Balta for US$ 24.77 million. Codan also owns the controlling stake in Lithuania's largest insurance company, Lietuvas Draudimar. Hansapank (Estonia) is likely to emerge as a major player in Latvia's life insurance market.

### *Leasing*

Latvia's major leasing companies have formed a new leasing association. Four leasing companies have seceded from the Latvian Leasing Association to form a new public organisation, the Association of Latvian Leasing Issuers. The four new founders are Hanza Lizings, Unilizings, Optiva Lizings and Nordea Finance Latvija.

## EBRD business development programmes

### The EBRD Baltic Business Advisory Service (BAS) Programme

The BAS Programme provides practical business advice to SMEs by implementing and managing clearly-defined, short term projects with rapid pay-back periods. It is funded by the Nordic countries' Baltic Technical Assistance Special Fund (BTASF) and by EU Phare.

The BAS Programme assists enterprises to remove barriers to growth and development, to enhance competitiveness and management effectiveness, and to prepare for EU accession. Qualified local consultants are used to the maximum extent possible. The BAS Programme currently works with 301 Baltic consultants, compared with 55 when the Programme started in 1995. Where the assignments are beyond the capabilities of local consultants, foreign consultants are contracted and in many cases twinned with local consultants to promote knowledge transfer. Up to 50 per cent (to a maximum of € 9,000) of the cost of each project is contributed by BAS, and the remaining cost is covered by each enterprise.

As of 31 December 2000, the BAS Programme had financed a total of 1,300 projects with 900 enterprises. Enterprise clients in total employ 98,000 and generate total revenues of € 3.6 billion. The programme now includes companies with less than 50 employees, the fastest growing business sector in terms of employment. This "micro-BAS" programme is also funded by the BTASF.

### The EBRD TurnAround Management (TAM) Programme

The TAM Programme transfers management and technical know-how to enterprises in the EBRD's countries of operation, assisting these enterprises to develop the skills necessary to succeed and grow in free market economies.

The TAM Programme works directly with individual enterprises, advising each, as appropriate, on: developing management skills, business planning, restructuring, improving products and reducing operating costs, meeting EU criteria for manufacturing and production, and on the development of local and export markets.

In the course of each project, particularly in the EU accession countries, TAM additionally advises on environmental impact, optimisation of energy and materials use, and on improvement of health and safety of employees at work. TAM also advises on how to access external investments and/or loans.

Enterprises selected for TAM projects have 300-3,000 employees (less than 300 when turnover is more than US$ 2 million), and are engaged in manufacturing of industrial and consumer products, as well as heavy industry, food processing and transportation. The TAM Programme sends a suitably qualified Senior Industrial Advisor (SIA), with long experience at top management level in the same industry sector, to work with the enterprise's management for about 30 days spread out over 12 to 18 months. The SIA also brings in one or more specialists to deal with particular functional areas such as MIS and marketing.

The impact of TAM in the Baltics is illustrated by the fact that the aggregated sales of the 164 Baltic enterprises with which TAM projects have been implemented is US$ 3.2 billion (i.e. about US$ 20 million per enterprise on average), and 53 of these have been able to mobilise US$ 448 million of external financing (investments and loans) during or after TAM assistance. TAM enterprises employ 132,000 people.

# EBRD activities in Latvia


***As at 31 December 2000, the European Bank for Reconstruction and Development (EBRD) had committed a total of € 304.6 million for 24 projects[1] in Latvia. Of these, eight were public sector loans totalling € 170.2 million, focusing on urgently needed repairs and investments on the energy supply and demand side, the Daugava hydro scheme, water supply and waste-water treatment in Riga, the Ventspils Port rail terminal, and road and airport upgrading.***

Private sector projects consisted of one credit line to a local bank to finance small and medium-sized enterprises (SMEs), three loans to local banks, five equity investments in local banks, three facilities (including a subordinated loan and a syndicated loan facility) to local banks, and one stand-by revolving credit facility. In addition, loans were made to complete and refurbish a major hotel in Riga, to construct a business centre in the capital, to finance a private sector mobile communications project, and to build and operate a port terminal.

## Overview of EBRD activities and key objectives

The EBRD's strategy continues to target the following transition objectives:

- the modernisation and expansion of the private enterprise sector, including SMEs, and the improvement of its international competitiveness;
- strengthening the financial sector as a means of mobilising increased levels of longer-term domestic savings and ensuring an efficient allocation of these resources in support of investment requirements in the economy;
- supporting the completion of the liberalisation, restructuring and, where applicable, privatisation, of the infrastructure sectors, including at the municipal level, as well as promoting private sector participation in those sectors;
- improving governance, particularly as it relates to the private enterprise sector, the financial sector and the restructuring/privatisation of infrastructure;
- transferring management skills at the enterprise level and further assistance in improving frameworks for markets, particularly in fields such as secured transactions and regulation.

The EBRD's activities focus on the following priority areas and instruments:

### *Financial intermediaries*

The EBRD is prepared to assist local banks in further diversifying their product ranges and financing structures to allow them to reach western efficiency levels while further developing current core activities. The Bank will seek to expand its involvement to non-banking financial institutions, such as pension funds. The EBRD will continue to rely on local banks and regional private equity funds to support the development of SMEs through loans and equity investments respectively.

### *Direct support for private enterprises*

As a result of the growth of Latvian enterprises, increasing opportunities for direct EBRD financing should increasingly materialise. Enterprises seeking financial support are likely to be in the following sectors: service industries (including those related to the transit of east-west trade), transport, technology, real estate, agribusiness, forestry and wood processing, and in selected other manufacturing industries. The Bank will support both domestic enterprises and those involving foreign strategic investors.

### *Restructuring/privatisation and involvement of private sector in infrastructure*

The EBRD is prepared to participate in selected privatisation transactions, particularly in projects related to infrastructure. A priority sector for EBRD involvement would be the power sector. Other infrastructure projects (e.g. municipal district heating and transport, port terminals, railways, oil transhipment pipelines), a number of which are closely related to Latvia's transit role in east-west trade, may receive support. The establishment and funding of the activities of energy service companies (ESCOs) to cover investment needs in the energy efficiency field will also be promoted.

The EBRD will continue to be active in the environmental sector. The Bank continues to seek to mobilise additional sources of financing, both public and private, including through co-financing with local banks.

## Signed projects as at 31 December 2000

### *Energy sector emergency investment*

In December 1992 the EBRD made a loan of € 31.7 million to help address urgent problems in energy supply and to improve energy efficiency and domestic energy conservation. The

[1] *This total excludes projects funded by regional funds*

project also started the process of upgrading the commercial basis of Latvia's energy utilities and improving their financial management. In addition, the project had a positive impact on the environmental performance of Latvia's energy sector.

### Riga International Airport upgrading

In October 1993 the EBRD made a loan of US$ 12.1 million to the Riga International Airport Enterprise to upgrade the existing runway, part of the taxiways and the lighting system. The project was designed to ensure aviation safety and continued operation of the airport as well as support for the development of an appropriate institutional and regulatory framework for the airport.

### Investment Bank of Latvia

The Investment Bank of Latvia (LIB) was set up in 1992 under the auspices of the Baltic Investment Programme and sought to promote Latvia's economic development by lending to local SMEs. In February 1994 the EBRD took an equity share of DM 5.4 million in LIB, half of which was financed by the Baltic Investment Special Fund. This participation in the equity capital of the LIB was sold to MeritaNordbanken, a strategic investor, at the end of 1997.

### Radisson Daugava Hotel

In summer 1995 the Radisson Daugava Hotel opened after its refurbishment, becoming an international four-star hotel with 357 rooms, long-term apartments, restaurants, business centre and conference and health facilities. The refurbishment was financed by loans of US$ 12 million from the EBRD and US$ 5 million from Finnish Export Credit Ltd extended in September 1994. The hotel was renovated by Polar-BEK Daugava Ltd, a Latvian joint venture comprising Polar-BEK International (US-Finnish development company), Radisson SAS Hotels (as operator) and Riga City Enterprise.

### Road upgrading

In December 1994 the EBRD made a loan of US$ 10.4 million to the Latvian government to finance road upgrading. The proceeds of the loan have financed the Latvian Road Administration's resurfacing programme on the main road network, completion of the Jelgava Bypass, equipment for winter maintenance, traffic surveys and material testing, and assistance to the Latvian Road Department in reorganising its maintenance activities and in implementing the project. Total project cost is estimated at US$ 26.8 million, with US$ 10.4 million financed by the Export Import Bank of Japan (JEXIM).

### Latvijas Zemes Banka

In February 1995 the EBRD extended a credit line of US$ 10 million to Latvijas Zemes Banka (LZB), a privately owned commercial bank. LZB used the credit line to on-lend to private sector SMEs. The Baltic Investment Special Fund funded 35 per cent of the credit line. In April 1996 an equity participation of € 1.8 million was signed. LZB was acquired by Hansabanka in 1997.

### Latvijas Unibanka

In December 1995 the EBRD extended a credit line of US$ 20 million to Latvia's then largest bank, Latvijas Unibanka. The loan has been used to provide medium-term financing to SMEs. In May 1996 an equity contribution of € 7.74 million was signed, and was sold to SEB in February 1999. In November 1999, the EBRD jointly arranged together with Bankgesellschaft Berlin AG, a syndicated loan of € 30 million to Latvijas Unibanka, providing itself a € 10 million five-year loan, the first loan to a Latvian bank since the Russian crisis. In July 2000 Latvijas Unibanka was the first Latvian bank to receive financing under the SME finance facility launched by the EBRD and the European Commission in April 1999. The € 10 million credit line aims to promote further growth of Latvia's SMEs, and particularly small companies.

### Eurovision – Latvia

Latvia was one of 15 central and east European countries to benefit from the extension of the Eurovision network. Under the programme, Latvia borrowed € 1.0 million for the partial financing of one transmit-and-receive earth station, allowing it to be linked to the Eurovision network by satellite.

### Pirma Latvijas Komercbanka

In November 1996 the EBRD signed an equity investment of € 4.4 million to improve the capitalisation of Rigas Komercbanka (RKB), the then third largest commercial bank in Latvia.

This was followed in early 1998 by a stand-by facility. Following the Russian crisis in 1998, the EBRD participated in the restructuring of the bank, which reopened in October 1999 as Pirma Latvijas Komercbanka (Pirma Banka). As part of the recapitalisation, the EBRD committed up to US$ 9 million in debt and equity finance. In May 2000, the EBRD sold its stake in Pirma Banka to Norddeutsche Landesbank Girozentrale (Nord/LB, Germany) as the strategic investor.

### *Daugava hydro schemes upgrade*

In April 1996 the EBRD made a loan of US$ 34.1 million to Latvenergo, the state-owned electricity utility, to enable it to upgrade six hydropower units in two hydropower plants on the Daugava River. The loan is designed to support commercialisation of the power sector and to prepare it for future private sector participation. It will also improve the operational and energy efficiency of power generation and develop Latvia's role as the provider of peak power to the Baltic region.

Total project cost is US$ 83.5 million, with co-financing from the European Investment Bank, JEXIM, export credit agencies and Latvenergo.

### *Riga water and environment project*

The EBRD signed the Riga water and environment project, its first in the sector, in August 1996. The Bank provided a loan of € 23.5 million towards a total project cost of € 131.3 million. The project involved tariff reform and a corporate partnership programme with the Stockholm Water Company. The loan aimed at helping transform the municipally owned utility into an autonomous self-financing service enterprise with clear financial and operational performance targets.

### *Riga Water Company corporate loan*

In November 2000 the EBRD made a loan of € 39 million to the Riga Water Company to improve the municipal water and waste-water system, and to refinance the existing state guaranteed EBRD loan. The loan will provide funding for the construction of sludge deposits for Riga's waste-water treatment plant, installation of water meters in the city and water networks in two neighbourhoods. Riga Water Company is the first local service utility in Latvia to receive a direct corporate loan from an international institution. The loan does not involve any sovereign guarantee and is backed by an undertaking of municipal support by the city of Riga.

### *Valdemara Centre SIA*

In December 1996 the EBRD made a loan of US$ 4.75 million (with an additional subordinated loan of US$ 1.52 million) to Valdemara Centre SIA. This company was established by Skanska International Building and Riga City Council to develop, design, construct, market, manage and operate a business centre in Riga city centre.

### *Baltcom GSM mobile communications*

In June 1997 the EBRD made a loan of US$ 23 million to Baltcom GSM, a Latvian company, to construct and operate a mobile communications network using the GSM 900 standard. With a total cost of US$ 67 million, the project aimed to modernise and develop the communications services in Latvia and to facilitate business activities through the provision of a national mobile network. It also assisted in the reform and liberalisation process of the Latvian telecommunications sector by introducing greater competition into the mobile communications market.

### *Saules Banka*

As part of its ongoing strategy of financing the private sector through reputable banks, the EBRD extended in October 1997 a US$ 8 million credit line to Saules Banka, to allow it to provide medium-term funding to small and medium-sized private enterprises.

### *Hansabanka*

In December 1997 the EBRD made a subordinated loan of US$ 4 million to Hansabank-Latvia (HBL), the then sixth-largest bank in Latvia. The project aimed to improve the bank's capitalisation and to diversify its capital base. It also allowed the bank to expand its business activities, including its private sector loan portfolio, and to meet new enhanced central bank prudential requirements. In 1998, the bank acquired Latvijas Zemesbanka, in which the EBRD was a shareholder, and the enlarged bank was renamed Hansabanka and is currently the third largest bank in Latvia.

### *Ventspils port rail terminal project*

In December 1998 the EBRD made a loan to Latvia Railways. The EBRD's US$ 20.5 million loan together with the European Investment Bank's loan of € 34 million is being used to modernise rail track in Latvia's principal rail corridor and to upgrade the rail network at Latvia's main sea port. The EBRD's loan finances construction of a new rail yard (Juras Parks) and a northern rail bypass at the port of Ventspils. This will streamline the port's operations and increase its capacity. The project, which is structured to meet EU environmental, health and safety standards, will improve environmental safety.

### *Ventspils port terminal*

A loan of € 9.9 million was provided by the EBRD in June 1999 for the construction and operation of a new multi-purpose terminal in the Baltic sea port of Ventspils. The financing was extended to SIA Noord Natie Ventspils Terminal (NNVT), a limited liability company incorporated in Latvia.

### *Baltic states regional equity funds*

Baltic Investment Fund The Baltic Investment Fund (BIF) was established to undertake equity and equity-related investments primarily in medium-sized enterprises in Estonia, Latvia and Lithuania. The EBRD's commitment was for up to US$ 6.25 million, with co-financing from the Baltic Investment Special Fund of up to US$ 6.25 million, and for a total Fund size of US$ 25 million. The purpose of the BIF is to stimulate joint ventures and other investments in the region. A second transaction with similar objectives (BIF III LP) was signed in 2000 with an EBRD contribution of € 8 million, a € 5 million contribution from the Baltic Investment Special Fund, and for a total Fund size of € 45 million.

### *Baltic Post-Privatisation Fund (PPF)*

The € 34 million Baltic Post-Privatisation Fund was launched in late 1996, initially as a separate country fund for Lithuania and for Latvia, and combined in mid 1998 to form a regional Baltic fund targeting private equity investments in Lithuania, Latvia and Estonia. The Fund's committed capital comprises € 30 million from the EBRD, in the form of a managed account, and € 4 million as a co-investment facility committed by the Fund manager.

The Fund is managed by Scandinavian Baltic Development Ltd, based in Stockholm and with offices in Vilnius, Riga and Tallinn. The Fund is targeting medium-sized manufacturing and service companies operating in the Baltic states that may require turnaround and restructuring or may have difficulty in attracting long-term capital, and offer attractive investment potential. The fund is expected to be fully invested by the end of 2001.

### *Baltic Small Equity Fund*

The Fund was set up in late 1997 to invest in SMEs in the three Baltic states, and its operation is based on a partnership between the Fund and the investee companies. The Fund takes a minority stake in the investee companies, with investments in the range of US$ 25,000 – US$ 400,000.

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**Signed projects as at 31 December 2000 (in € million),** exchange rates as at 31 December 2000

| Operation name | Sector | Total cost | EBRD Debt | EBRD Equity | EBRD Total |
|---|---|---|---|---|---|
| **Private sector** | | | | | |
| Hansabanka (subordinated debt) | Finance | 4.3 | 4.3 | 0 | 4.3 |
| Hansabanka (equity investment) | Finance | 3.0 | 0 | 1.8 | 1.8 |
| Hansabanka | Finance | 10.3 | 6.0 | 0 | 6.0 |
| Latvia GSM Mobile Communications | Telecommunications | 107.5 | 23.1 | 0.2 | 23.3 |
| Saules Banka (credit line) | Finance | 5.8 | 5.0 | 0 | 5.0 |
| Latvijas Unibanka (equity investment) | Finance | 10.7 | 0 | 7.7 | 7.7 |
| Pirmas Latvijas Komercbanka (equity investment) | Finance | 10.5 | 0 | 4.4 | 4.4 |
| Valdemara Centre SIA | Property | 21.1 | 7.2 | 0 | 7.2 |
| Latvijas Unibanka | Finance | 21.5 | 11.8 | 0 | 11.8 |
| Daugava Hotel | Tourism | 46.0 | 12.9 | 0 | 12.9 |
| Pirmas Latvijas Komercbanka (Stand-by Facility) | Finance | 10.7 | 9.7 | 0 | 9.7 |
| Investment Bank of Latvia (equity investment) | Finance | 7.9 | 0 | 1.4 | 1.4 |
| Ventspils Port Multi/Purpose/Intermodal Terminal | Finance | 32.5 | 9.9 | 0 | 9.9 |
| Pirma Latvijas Komercbanka (equity and debt) | Finance | 100.4 | 4.5 | 4.5 | 9.0 |
| Latvijas Unibanka (syndicated loan) | Finance | 30.0 | 10.0 | 0 | 10.0 |
| Latvijas Unibanka (SME finance facility) | Finance | 10.0 | 10.0 | 0 | 10.0 |
| ***Subtotal private*** | | ***432.2*** | ***114.4*** | ***20.0*** | ***134.4*** |
| | | | | | |
| **Public sector** | | | | | |
| Ventspils Port Rail Terminal Project | Transport | 94.8 | 22.0 | 0 | 22.0 |
| Daugava Hydro Schemes Upgrade Project | Energy | 84.3 | 32.3 | 0 | 32.3 |
| Riga Water and Environment Project | Municipal infrastructure | 139.7 | 24.2 | 0 | 24.2 |
| Riga Water Company Corporate Loan | Municipal infrastructure | 160.4 | 36.0 | 0 | 36.0 |
| Eurovision Latvia | Media | 1.0 | 1.0 | 0 | 1.0 |
| Road Project | Transport | 28.8 | 11.2 | 0 | 11.2 |
| Riga International Airport | Transport | 14.2 | 11.2 | 0 | 11.2 |
| Energy Sector Emergency Investment | Energy | 51.0 | 32.3 | 0 | 32.3 |
| ***Subtotal public*** | | ***574.2*** | ***170.2*** | ***0*** | ***170.2*** |
| | | | | | |
| **Total** | | **1,006.4** | **284.6** | **20.0** | **304.6** |
| of which private | | | | | 44% |
| of which public | | | | | 56% |